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PRESS RELEASE

Eastern European Outlook: Shaky recovery, budget austerity, slow thaw in lending

Eastern Europe is the region hardest hit by the global credit crisis and recession, largely due to its relatively large exposure to foreign currency borrowing. During the summer, the economic cycle has nevertheless bottomed out in Eastern Europe as well. But the recovery will be shaky and uneven. The main reasons are public sector budget consolidation and the fact that credit tightening will ease only slowly, predicts SEB in its October 2009 issue of *Eastern European Outlook*.

Exports will gradually strengthen. Domestic demand will remain weak in the coming year, however; households will be squeezed by a weak wage and salary trend and by rising unemployment, while corporate capital spending will be hampered by large idle production capacity and cautious lending practices.

"Our conclusion is that the recovery in Eastern European will be highly dependent on a continued upturn in the world economy, especially in the euro zone, which is a major export market for Eastern Europe," says Mikael Johansson of SEB Economic Research, Chief Editor of ***Eastern European Outlook***.

Poland is the only EU country to start its recovery without having fallen into recession, and ***Eastern European Outlook*** expects a continued gradual strengthening of Polish growth in 2010-2011. Russia will recuperate at only a moderate pace from its historic GDP decline in the first half of 2009, despite being buoyed by higher commodity prices. The Ukrainian economy will return to only weak positive growth in 2010. Of the three Baltic countries, Estonia is best positioned for recovery, with GDP growth ending up around zero in 2010 and rising the year after. In Latvia and Lithuania, GDP will continue to shrink next year, though only moderately. These countries will resume positive growth on an annual average basis only in 2011.

In many countries of the region, certain key economic imbalances such as large current account deficits and high wage-driven inflation have been wiped out. Remaining as challenges are necessary budget corrections after very large 2009 deficits in many countries, higher than in the euro zone. Thanks to continued international bail-out loans, ***Eastern European Outlook*** expects hard-pressed Latvia and Ukraine to avoid suspension of payments.

In the Baltics, depressive economic forces will remain in place next year. Painful austerity policies will continue, including further pay cuts to restore lost competitiveness. Political tensions have increased, especially in Latvia and Estonia. There is a risk that exchange rate worries will re-emerge in the run-up to the Latvian Parliament's vote on the 2010 budget. It is also still an open question whether Estonia will meet the vital budget deficit criterion for the desired euro zone accession in 2011.

"Our main scenario is that the Baltic countries' fixed exchange rates against the euro will survive and that the international loan programme will remain on track. The coalition government in Latvia will probably work out a new austerity proposal for 2010 that the EU, the IMF and the Nordic countries will accept," Mr Johansson concludes.

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