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Press release

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Eastern European Outlook: Export-driven growth gains strength as domestic demand awakens

Economic conditions in Eastern Europe (including "Central Europe") will strengthen in 2011-2012, although fiscal policies will be tightened moderately in many countries and global growth will level out. Strong, competitive exports will remain a key driving force this year. Meanwhile consumption and capital spending are awakening from their crisis-period hibernation and will help sustain good GDP growth. Eastern Europe was the region of the world hardest hit by the global credit crisis, mainly due to relatively large borrowing in foreign currencies, writes SEB in its March 2011 issue of Eastern European Outlook.

The first signs of recovery in private consumption came in 2010, alongside a rebound in real wage growth, stabilising labour markets and some thawing in frozen credit conditions. Looking ahead, continued decline in unemployment, faster wage and salary hikes and gradual normalisation in the credit situation will contribute to growing consumption.

Rapidly accelerating inflation due to sharply higher global energy and food prices will partly undermine household purchasing power this year. Underlying inflation pressure is low but is gradually increasing. Looking ahead, the commodity price upturn will moderate. The increase in broad inflation measures will culminate this year, except that in Estonia and Lithuania inflation will continue to accelerate in 2012.

Large public budget deficits in the wake of the crisis will shrink to more moderate levels in most countries. Estonia's deficit will rise slightly from a low level. Public sector debts will continue to grow somewhat; they are low or moderate, compared to many Western countries.

"Painful austerity policies in the Baltics will soon fade away. In our assessment, these countries' internal devaluations, including sharp pay cuts, are over. Private wages and salaries have been increasing again since late 2010. Latvia's budget tightening will continue this year, but Lithuania's fiscal policy will be more neutral. In Estonia we expect fiscal policy to be expansionary. Budgetary challenges still remain, however. Latvia and Lithuania are still running large budget deficits, and their governments' ambition to bring the deficit down to a maximum of 3 per cent of GDP in 2012 to prepare the way for euro zone accession in 2014 is in danger. Some further tightening may be required in Lithuania," says **Mikael Johansson**, Head of Eastern Europe Research and Chief Editor of Eastern European Outlook.

SEB's GDP forecasts for 2011-2012 will remain somewhat above consensus, except in Ukraine:

- **Russia's** GDP will increase by 5.6 and 5.2 per cent, respectively, in 2011-2012, sustained by high commodity prices. SEB is now raising its Brent oil price forecast for 2011 to USD 102/barrel from USD 96/barrel. "Higher oil prices will provide an extra growth impulse and room for a continued expansionary fiscal policy, although in the short term there is increased uncertainty about consumption due to rapidly rising inflation," notes **Andreas Johnson**, Russia analyst at SEB Economic Research, who predicts that the central bank will continue to tighten monetary policy and that the rouble will appreciate further.
- **Poland's** growth will become more investment-driven, rising to 4.5 and 4.6 per cent. "An expansionary fiscal policy sustained demand during the crisis, with large budget deficits as a consequence. Further fiscal

tightening will be needed after the autumn parliamentary election in order to meet nationally established debt limits," according to **Daniel Bergvall**, Poland analyst at SEB Economic Research, who predicts that the key interest rate will continue to be raised and that the zloty will appreciate.

- **Ukraine's** growth will improve slightly to 4.7 per cent this year. Favourable world market prices for steel and agricultural products, two major export industries, will provide support but austerity requirements imposed by Ukraine's lender, the IMF, will restrain growth.
- **Estonia's** GDP increase will accelerate to 5.0 and 4.5 per cent, respectively, in 2011-2012. The export boom is continuing, while domestic demand is gradually picking up. An unexpectedly rapid labour market improvement will help fuel consumption. Austerity policies have eased.
- **Lithuania's** growth will surge to 4.0 and 4.5 per cent in 2011 and 2012. Exports will continue to drive growth, which will nevertheless become more broad-based as fiscal tightening softens this year. Emigration and growing labour shortages will hamper the upturn.
- **Latvia**, whose upturn is lagging behind Estonia and Lithuania, will see GDP growth pick up to 4.0 per cent in 2011 and 4.5 per cent next year, but the domestic economic recovery will be shaky. This is partly because public budget consolidation is continuing.

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