Press release

Stockholm, March 28, 2012

Eastern European Outlook: Increased polarisation – Russia and Poland withstanding the euro zone crisis well

Eastern (including Central) Europe also began an economic deceleration in the second half of 2011. But as SEB predicted, regional heavyweights Russia and Poland have withstood the international crisis well. SEB still expects their slowdown to be mild due to moderate exports in relation to GDP, modest public debt and small or moderate dependence on bank financing via the euro zone, which is in recession this year. Russia is also benefiting from high oil prices, writes SEB in its March 2012 issue of *Eastern European Outlook*.

Precisely because of differences in dependence on the euro zone's banking system and import demand, the economic trend in Eastern Europe is becoming more and more polarised. The northern parts, including Russia and Poland, will resist the euro zone crisis relatively well, while some central and especially southern parts of the region will be harder hit. The three Baltic countries and the Czech Republic are among the "medium hard hit" while Bulgaria, Croatia, Romania, Hungary and Ukraine are the "hardest hit", as a consequence of their relatively strong banking links with the euro zone, although Ukraine will muddle through with decent GDP growth.

By supplying low-cost loans to banks and other financial institutions in the euro zone, the European Central Bank's long-term refinancing operations (LTRO I and II) have greatly reduced the risks of a severe, lengthy credit crunch in Eastern Europe too. But credit conditions tightened in the region late in 2011 and will only gradually revert to normal during the coming year.

"The ECB's loans to the euro zone banking system have proved to be a successful move. Interbank borrowing costs have fallen in both Western and Eastern Europe in the past few months. But some stress symptoms persist, partly due to continued uncertainty about the euro question in Greece and Portugal. This spills over into Eastern European banks as well, since the banking sectors of many countries in the region are largely owned by Western banks. This indicates that credit conditions will remain abnormally tight at least during 2012, something that will also hamper economic growth," says **Mikael Johansson**, Head of Eastern European Research at SEB and Chief Editor of *Eastern European Outlook*.

Inflation will fall this year in most Eastern European countries, but core inflation will remain relatively high in Estonia and Poland. The recent oil price surge is a general upside risk in inflation forecasts.

In all six countries covered by *Eastern European Outlook*, growth will drop somewhat below trend in 2012-2013 – in the Baltics considerably below trend this year. A rebound will occur in 2013.

Russia's GDP will increase by 3.8 per cent in 2012 and 4.1 per cent in 2013. The economy will be sustained by high oil prices, high real wage growth and expansionary fiscal policy. Yet long-term question marks remain, due to heavy commodity dependence and a slow pace of reform. There may be some opening for reforms now that Vladimir Putin is returning as president.

"We still have a positive view of Russian growth in the short term. At the same time, Russia ought to be capable of achieving even higher growth, say 6-7 per cent, considering the high oil prices. This underscores the need for more reforms. When Russia joins the World Trade Organisation this summer, it will be a step in the right direction that may facilitate trade and investments. But we should not expect that this will automatically solve Russia's structural problems," says **Daniel Bergvall**, Russia and Ukraine analyst at SEB Economic Research.

- **Poland's** growth will slow a bit to 3.0 per cent in 2012 and then accelerate to 3.6 per cent in 2013. Capital spending will increasingly drive the economy. Fiscal policy will continue to tighten, while monetary policy will shift and key interest rates will be cut twice during the second half of 2012. The zloty will gain further strength after its recent volatility.

- **Ukraine's** growth will dip to 3.2 per cent in 2012 but reach 4.2 per cent in 2013. High steel and agricultural prices will provide support. Relations with the International Monetary Fund and the European Union are tense. If growth appears to be falling further, Ukraine may bend to IMF demands, enabling its frozen loan agreement to be resumed.

- **Estonia's** growth will fall abruptly to 1.5 per cent in 2012 and climb to 2.5 per cent in 2013. Weaker demand in Sweden and Finland is hurting expansion. Private sector deleveraging continues, and net debt has fallen sharply. High inflation will persist.

- **Lithuania's** growth will decelerate sharply this year and rise to 3.0 per cent in 2013. The government is aiming at euro zone accession in 2014 but will have difficulty meeting the budget criterion; we predict conversion to the euro in 2015. The governing coalition will change after this autumn's parliamentary election.

- **Latvia** will decelerate more smoothly than Estonia and Lithuania, since it is not as export-dependent. Growth will fall to 2.5 per cent in 2012 and speed up to 4 per cent in 2013. Continued fiscal austerity will pave the way to euro zone accession in 2014 as planned.

For further information, please contact:
Mikael Johansson, Head of Eastern European Research, SEB Economic Research,
+46 70 372 28 26

Daniel Bergvall, SEB Economic Research,
+46 73 523 52 87

Press contact:
Elisabeth Lennhede, Press & PR
+46 70 763 99 16
elisabeth.lennhede@seb.se