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Press release

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Eastern European Outlook: Continued decent growth in northern Eastern Europe

Economic growth in Eastern (including Central) Europe has bottomed out in the past 3-6 months, as in the West. And just like the pattern in Western Europe, the northern part of Eastern Europe is performing better than the southern part. The three Baltic countries in particular, but also Russia and Poland, will continue to show decent GDP growth during 2013-2014 while Ukraine will remain mired in economic stagnation this year as well. Countries in central and southern parts of the region, such as the Czech Republic and Hungary, are climbing extremely slowly out of recession while Croatia and Slovenia will continue to show negative growth, writes SEB in the latest issue of its twice-yearly *Eastern European Outlook*.

The northern part of Eastern Europe is displaying relatively good resilience to the global slowdown and the euro zone debt crisis, largely because their economies and banking sectors are in relatively good fundamental shape and because Russia is benefiting from continued high oil prices of around USD 110/barrel. Countries in the southern part of the region have larger internal imbalances and their banks are squeezed more by the problems in Western Europe.

Unemployment is gradually falling in the Baltics and Russia, but will rise in Poland this year and remain stuck at a high level in Ukraine. Large emigration from the Baltics in recent years is causing some bottleneck problems in their labour markets. Although pay increases are generally speeding up, the cost situation is under control with the possible exception of Estonia. Export competitiveness thus remains good, after earlier internal devaluations. In Russia, the jobless rate has already dropped below its equilibrium level, generating cost pressures and growth problems generally. This year, inflation will continue to fall in the Baltics and Poland but rise somewhat in Russia and rebound clearly in Ukraine, despite its economic crisis.

A separate theme article in the report examines the euro timetable for the seven European Union (EU) countries in Eastern Europe that remain outside the euro zone. At present, only Latvia meets all the Maastricht criteria for euro zone membership, SEB's analysis shows. For a long time, SEB's assessment has been that Latvia will convert to the euro as planned in 2014; in this spring's coming evaluations by the European Commission and the European Central Bank (ECB), the country is expected to meet all the criteria by a wide margin. But no wave of new euro zone memberships by the EU countries in Eastern Europe can be expected; for most of them, accession will be delayed for some years. The main reason is that, except for Lithuania, their governments have made their ambition to adopt the common currency a lower priority due to the euro zone crisis.

"Most EU countries in Eastern Europe, except for Latvia and Lithuania, probably make the assessment that it is too uncertain to join the euro zone during the next few years. The crisis has made it unclear where the euro zone is headed, for example in terms of supranationalism in fiscal policy and the stability of the euro in general. These Eastern European countries are waiting to see the outcome of the euro zone crisis before the question of adopting the currency comes up again on their political agenda," says Mikael Johansson, Head of Eastern European Research at SEB and Chief Editor of *Eastern European Outlook*.

Here are the GDP forecasts for the six countries that *Eastern European Outlook* covers:

- **Russia's** growth will cool slightly to 3.0 per cent this year and 3.5 per cent in 2014. "Given historically low unemployment, the economy is already hitting its resource ceiling, and far-reaching reforms will be needed to lift its growth potential to President Vladimir Putin's 5-6 per cent target," says Andreas Johnson, Russia and Ukraine analyst at SEB Economic Research.
- **Poland** is recovering from a deep domestic slump, aided in part by the big decline in interest rates over the past six months – but the central bank is finished cutting interest rates. This year, GDP will increase about as much as last year, 2.1 per cent. In 2014, growth will speed up to 3.5 per cent, still below the potential rate of around 4 per cent.
- **Ukraine** will see zero growth again this year, and GDP will rise 1.8 per cent in 2014. The economy is hard pressed by a big current account deficit and sagging confidence. A new bail-out loan from the International Monetary Fund is needed, and a devaluation is expected in the second quarter of this year.
- **Estonia's** growth will accelerate from 3.2 per cent last year to 3.8 per cent in 2013 and 3.7 per cent in 2014. This is still below potential, which is roughly 4 per cent in all of the Baltic countries. As elsewhere in the Baltics, growth will be relatively balanced.
- **Latvia** remains the fastest-growing of all the EU countries. A temporary dip from last year's 5.5 per cent to 3.8 per cent will occur this year. In 2014, growth will revert to 5 per cent.
- **Lithuania's** GDP will increase by 3.2 per cent this year and 3.5 per cent in 2014, after last year's 3.6 per cent growth.

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