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Press release

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Eastern European Outlook, March 2015: Baltics and Central Europe resilient to Ukraine conflict and Russian recession

The Baltic countries and Central Europe are continuing to show good resilience to the Russia-Ukraine conflict as well as Russia's food import sanctions and accentuated economic weakness. This is mainly because of favourable economic conditions, including strong real household incomes (especially in the Baltics) that are allowing robust private consumption. Looking ahead, the prospect of improving exports to Germany will also provide support. But overall growth rates will be modest during the next couple of years as exports to Russia fall and weak business investments strengthen only slowly due to geopolitical turmoil in the region, writes SEB in the latest issue of its twice-yearly *Eastern European Outlook*.

As in the rest of Europe, inflation will remain very low in the Baltics and Central Europe, especially due to low energy prices. In Estonia, however, inflation will rebound relatively fast as a result of an increasingly tight labour market, with continued emigration contributing to increased labour shortages and continued high wage and salary growth. All three Baltic countries are struggling with emigration problems and underlying weak demographic trends.

SEB still expects the Russia-Ukraine conflict to be long-lasting and the ceasefire to be fragile.

"Sanctions policies are increasingly difficult to assess. This is because of a trend towards widening divisions within the European Union on a unified stance towards Russia, both for national economic and political reasons. Our main scenario is that Western sanctions will remain in place at least during 2015," says **Mikael Johansson**, Head of Eastern European Research at SEB and Chief Editor of *Eastern European Outlook*.

Russia is moving towards a large GDP decline this year due to the oil price downturn, the rouble-driven inflation shock and continued Western financial sanctions. Strong government financial reserves will provide protection over the next couple of years. But these reserves are meanwhile being drained and the Russian economy – already plagued by major structural problems – will be in far more fragile condition when it emerges from recession in 2017.

"Support for President Vladimir Putin remains strong, driven by his handling of Ukraine and his aggressive stance towards the West. Meanwhile the opposition has weakened greatly in recent years and will have difficulty organising in time for the 2016 parliamentary election, so there is little domestic political risk during the next couple of years," says **Andreas Johnson**, who is in charge of Russia and Ukraine forecasts at SEB Economic Research.

Ukraine is in an acute economic crisis, with nearly empty central bank reserves. The recently approved expansion of international bail-out loans and a coming debt write-down by private bond holders will enable the country to avoid default.

Here are the GDP forecasts for the six countries that *Eastern European Outlook* covers. SEB's forecasts for 2015 and 2016 are generally somewhat below consensus.

- **Russia's** GDP will fall by 5.0 per cent in 2015 and by 1.0 per cent in 2016. A slight oil price upturn will help stabilise the economy. The rouble is vulnerable but will gradually regain strength.
- **Ukraine** will see a continued GDP decline this year, totalling 6.0 per cent. The country's falling currency – which will turn around and show a slight appreciation – will contribute to weak export-driven growth of 1.0 per cent in 2016.
- **Poland**, with relatively solid fundamentals, will experience GDP growth of 3.4 per cent this year and 3.6 per cent in 2016, making it the fastest-growing economy in Central and Eastern Europe. The negative impact of Swiss franc appreciation on many Polish home mortgage loans will be relatively minor.
- **Estonia's** strongly export-oriented economy is slowly working its way out of a relatively deep 2013-2014 growth slump. GDP will rise by 2.2 per cent this year and 2.7 per cent in 2016.
- **Latvia** will see unchanged 2.4 per cent growth this year, following by an acceleration to 2.7 per cent in 2016. The approaching presidential election may lead to political instability, but the economy is robust.
- **Lithuania's** growth will slow a bit this year, to 2.6 per cent, but accelerate to a solid 3.5 per cent in 2016. The important energy sector will achieve a more secure situation, helped by a new liquefied natural gas terminal and electric power links that will radically decrease the country's dependence on imported Russian energy.

For further information, please contact
Mikael Johansson, Head of Eastern European Research,
SEB Economic Research
+46 8 763 8093, +46 70 372 2826
mikael.johansson@seb.se

Andreas Johnson, SEB Economic Research
+46 8 763 3082, +46 73 523 7725
andreas.johnson@seb.se

Press contact
Anna Helsén, Group Press officer
+46 8 763 9947, + 46 70 698 4858
anna.helsen@seb.se