SEB

Press release

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Eastern European Outlook, October 2015: Economic picture remains divided – Russian recession in 2016 too

The dual-track economic picture in Eastern (including Central) Europe will persist over the next two years. Conflict-plagued Russia and Ukraine will show continued weakness. In Russia, recession will linger during 2016 too, as plunging oil prices rebound only weakly and sanctions against the country by the European Union and United States are probably extended, though softened slightly. Meanwhile the Baltic countries, Central Europe and to some extent the south-eastern portion of Eastern Europe will continue to show decent economic growth, primarily sustained by growing domestic demand. Poland and the Czech Republic will lead the way, writes SEB in the latest issue of its twice-yearly report *Eastern European Outlook*.

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

The conflict has eased this autumn, but the various military and political promises made by the parties to the Minsk 2 agreement will be difficult to fulfil in their entirety by the December 31, 2015 deadline.

"Our main scenario is that at its January 2016 summit, the EU will extend its sanctions against Russia for a certain period of 2016, although it may soften them slightly. We believe that the US – which has been more strident than the EU about linking its sanctions to a condemnation of Russia's annexation of Crimea – will stick to its sanctions at least throughout 2016. Russia, which has already responded to the EU and US by extending its import ban on foods until next summer, will be the biggest loser in the war of sanctions, in our assessment," says Mikael Johansson, Head of Eastern European Research at SEB and Chief Editor of *Eastern European Outlook*.

Good conditions for households are the main reason why the Baltics and Central Europe will continue to show good resilience to the Russia-Ukraine conflict and economic weakness in those countries. Strong real incomes, increasing employment and only cautiously rising low interest rates will lead to good consumption growth. Capital spending activity, which has been relatively sluggish so far, will increase but remain hampered by nearby geopolitical worries. Modest export growth will gradually strengthen, due to increased demand from Germany (which weighs especially heavily for Central Europe) and the Nordic countries (relatively important markets for the Baltics). The Baltics will be harder hit than Central Europe by Russia's economic downturn and food import sanctions, because of their larger foreign trade exposure to Russia.

The inflation picture in Eastern Europe will also remain divided. High inflation in Ukraine and Russia, driven by earlier currency depreciation, has largely culminated in recent months and will gradually continue downward. In most other Eastern European economies, inflation is under strong pressure as in the West but is past its low point or is about to hit bottom. Inflation will climb only weakly as a consequence of relatively rapid pay growth. Continued low commodity prices will have a restraining effect.

Here are our 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 continue its decline in 2016 but the downturn will ease to 1.0 per cent from this year's 4 per cent. Growth will be slowed by low oil prices, sanctions and structural problems. In 2017 as well as in the long term, we expect growth to reach a low 1.5 per cent.

"Without far-reaching reforms that address such problems as Russia's poor business climate, weak capital spending and heavy dependence on oil exports, there are risks that economic growth will be very weak in the future as well," says Andreas Johnson, who is in charge of Russia and Ukraine forecasts at SEB Economic Research.

- **Ukraine** will see yet another sharp GDP decline this year, 12 per cent, and then experience weak growth in 2016-2017. The country's recent debt write-down agreement with private lenders and on IMF bail-out loans will contribute to stabilisation.
- **Poland** will see stable growth, accelerating a bit to 3.6 per cent in 2016 and 3.8 per cent in 2017. We expect a change of government after this autumn's parliamentary election. There are clear political dividing lines between the current government and its likely successor, but the growth picture will not change appreciably.
- **Estonia**'s 2015 growth forecast has been written down a few tenths of a point due to weak exports, but growth will rebound – sustained primarily by a consumption boom and strong demand from Sweden and elsewhere. GDP will increase by 2.7 per cent in 2016 and 3.4 per cent in 2017.
- **Latvia** will be the fastest-growing Baltic country. GDP will climb by 2.7 per cent next year and 3.5 per cent in 2017, but the latter is only a bit above potential growth.
- **Lithuania** will experience leisurely growth this year, slowed by Russian effects but also by low prices that have hurt the country's important refined oil exports. Growth will accelerate to a decent 3 per cent or so annually during 2016-2017.

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