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Analysis of the economic situation of the countries of Central and Eastern Europe.

Łukasz Białek

After 2012, the weakening of economic growth in the countries of Central and Eastern Europe (CEE) still continues in 2013, however, the second half of the year gives perspective to reverse the downward trend, i.e. due to the improvement in consumption after the reduction in interest rates. Moreover, the acceleration of the region's economy in the second half of 2013 and in 2014 forecasts is associated with the improvement of the situation in the euro area.

The main causes of the economic slowdown in the CEE countries was the eurozone crisis deepening in 2012, as well as the ongoing fiscal consolidation and private sector deleveraging process. The GDP rate growth that in 2011 in the region remained at the level of 3.1% fell to 0.7% in 2012, and in the fourth quarter decreased to zero[1]. The ongoing recession of the eurozone was one of the reasons for the slowdown in exports in the region. It should be noted, however, that countries of Central and Eastern Europe were undergoing economic downturn in different ways. Reduction in export growth occurred in all countries in the region, but the scale was significantly different.

[1] National Bank of Poland, Analysis of the economic situation of the countries of Central and Eastern Europe in 2013

The banks forecasts for the CEE region

According to the Polish National Bank, a small adjustment of export growth was observed in the Baltic countries, which by increasing export to the countries of the former USSR, compensated for the declining exports to the eurozone countries. The Slovak export which is based on the sale of cars that are in the first half of last year was the fastest growing export region, visibly slowed down in the second half of 2012, which led to the weakening of output growth in the automotive sector. Exports of Bulgaria and Romania decreased last year, which resulted from higher than in other CEE countries share of the euro area peripheral countries in foreign trade.[2]

The World Bank at the beginning of the year indicated in the published report that this year the region's economy is to slow down - it was supposed to grow by 1.3 per cent. In turn, the World Bank lowered its forecast for GDP growth in Poland in 2013 from 1.6 per cent expected in January in accordance with the issued report to 1.0 per cent. Nevertheless, it should be noted that the countries of Central and Eastern Europe are attractive for investments and grow faster than the euro area. In 2012, the region's GDP has grown by about 1%, and the eurozone was in recession. In 2011, growth in Central and Eastern Europe was 3.1% while in the euro area half of that, i.e. 1.5%.

IMF does not lower its ratings for the CEE

The International Monetary Fund, presenting in July the updated World Economic Outlook (WEO) report published forecasts for economic growth in the region of Central and Eastern Europe in accordance to which it is expected to accelerate from 2.2 per cent in 2013 to 2.8 per cent in 2014. Central and Eastern Europe is the only group of countries specified in the report for which forecasts have not been lowered for this or next year.[3]
Forecasted GDP growth around the world in 2013 and 2014 has been reduced by 0.2 percentage points to 3.1 per cent and 3.8 per cent respectively. "That's less than forecasted in April, which is largely the result of significantly weaker domestic demand and slower growth in several key emerging economies, as well as a long-lasting recession in the euro area" the report said. According to the report, “There prevail risks that the growth is weaker. Old risks persist and new ones arise, including the possibility of a long slowdown in emerging economies, particularly the risks of lower potential growth, which slows down the possibility of increasing credit and financial conditions, if the anticipated reduction of monetary stimulation in the U.S. leads to a permanent reversal of capital inflows".[4] The IMF predicts in the World Economic Outlook published in April, that economic growth in Poland will accelerate from 1.3 per cent in 2013 to 2.2 per cent in 2014.

[2] National Bank of Poland, Analysis of the economic situation of the countries of Central and Eastern Europe in 2013

[3] International Monetary Fund, World Economic Outlook 2013

[4] International Monetary Fund, World Economic Outlook 2013

Central and Eastern Europe attractive to investors

Despite the global turmoil and economic slowdown, Central and Eastern Europe countries are still considered by global investors as the area with high growth potential. As a result, the amount of foreign direct investments in the countries of the new Europe, particularly long term investments is expected to continue to grow. The attractiveness of the region also results from the fact that the European Union through its funds provides financial support to the countries of the region encouraging their development.
Importantly, the impact of the EU also includes those countries that in the longer term are to undergo the process of joining the structures of the EU (e.g. Turkey, Ukraine). These conditions support the development of companies in the region, resulting in the increase in their value. Investment funds for many years invest in Central and Eastern Europe, concentrating its assets primarily in equity securities of the best companies with great growth potential.

Another important aspect that can weaken economy of the region affecting foreign direct investment is a crisis in the eurozone and still not completely stabilised situation in the USA. Economic growth, in particular in the first half of the year is to be driven by external demand. Across the region as early as in 2012 there was visible diversification of foreign trade due to increasing the share of export to countries outside the EU, such as Russia, China and Turkey. If, according to World Bank projections, in the second half of the year we would have to deal with the recovery in the eurozone, these would be the two major stimulants and sources of economic growth in the CEE countries, which would undoubtedly make investors convinced with regards to the allocation of funds in the region.

As for various studies and reports (including annual “European Attractiveness” survey carried out by Ernst & Young), the fastest developing countries of Central and Eastern Europe are to be Poland, and then the Czech Republic and Romania. It is important that the CEE countries implement a series of actions, interventions that can solve current and future macro-economic determinants (except, of course, further improvement of the offer for investors in terms of taxes, labour costs, etc.). Current labour market remains very weak, growth of employment and wages steadily weakens: employment growth has slowed, as the increase in real wages.

All this indicates the weakness of consumption. In the past, the weakness of the labour market was balanced when consumers spent their saving, but this time the savings are too low. One of the main areas where changes are necessary is the consolidation of public finances, which shall enable the economy to cope with the lower potential economic growth, associated with lower growth in exports. It is therefore extremely important to continue to further diversify export, to seek "independence" from the markets of the euro area. This is also important because of the increased competitiveness in the international markets of emerging countries, including the BRICS.

The reasons for increased interest and confidence of foreign investors in the Polish market can be found in the fact that other countries of the continent were much more affected by the global crisis. Region of Western Europe experienced over the years 2005-2012 a decrease in the level of attractiveness which dropped from 63 per cent to 33 per cent. In the same period, despite the temporary upward trend, there was a reduction in the investment attractiveness of the region of Central and Eastern Europe - 55 per cent in 2005 and only 21 per cent in 2012, respectively. Poland is the largest of the countries of Central and Eastern European beneficiary of Structural Funds, with EUR 67.3 billion allocated for the period 2007-2013.

High growth potential of the enterprises in the CEE region – Top 500 CEE 2013.

Another important information results from the analysis of the largest 500 companies in Central and Eastern Europe - CEE 2013 Top 500 ranking. The list includes the top 500 companies in the region, in terms of turnover; other parameters were also taken into account, such as the level of employment and a framework structure of companies, industries, markets.

In the opinion of the international insurer[5] 2012 and 2013 were difficult even for the emerging areas of Europe, but the analysis of the largest 500 companies indicates the existing potential for growth, even in times of economic hardship. Economic downturn has not shaken the position of the strongest entrepreneurs, but it affected their results. Major companies of Central and Eastern Europe increased its turnover by 5%, but profit of all five hundreds decreased by 32%. Leading companies of the region have demonstrated, however, its importance not only in the region but also in Europe and on the most important to them commercial markets worldwide. Oil and energy companies are the leaders, as usual. We are expecting more powerful companies in the sector of new technologies to represent our region of Europe as well as an increase in the number of serious investors grown in the native region and investing their activities outside the region. Observing the Polish market it can be said that the changes are noticeable. This is largely due to the consistent management by the business leaders who seek to achieve their vision of creating a strong company that is capable of international expansion and competing with global players.[6]

Despite the economic crisis, in 2012 the 500 largest companies in the region improved their sales by 5%, i.e. to more than EUR 628 billion. However, these results did not cause steady growth in net profits. Although in 2011 the largest companies in Central and Eastern Europe reported higher profits, in 2012 profit levels fell by almost 32%, from EUR 30 billion to EUR 20 billion. The level of employment in the region's 500 largest companies shows an increase - the number of employees increased slightly by 1.5% compared to the previous year. However, the overall picture is quite different - the survey shows that rising unemployment in most cases goes hand in hand with high levels of redundancies in the largest companies.

Once again, most companies in the CEE TOP 500 represent the fuel sector. 65 companies generated a gain in total amount of EUR 162 billion (+6%). The year of 2012 was difficult especially in this sector, as the total net profit decreased by 34.6%.

The energy sector came in the second place – with a significant loss in comparison to the leader. 51 companies in that industry have not reached even half the turnover of the fuel sector (EUR 76 billion). The average growth rate in the sector looks quite promising (11%), but companies in the industry - in response to reduced energy demand due to the recession - decreased employment (-12.9%) and had to put up with a sharp drop in profit.

This year, the automotive industry was able to enter the top three. 42 enterprises in the sector achieved sales of almost EUR 63 billion, and in this regard the leading countries are: the Czech Republic and Slovakia (enough to mention such companies as: Skoda Auto S.S., Volkswagen Slovakia, KIA Motors). Other companies which rank very high in the study are, for example, Mercedes -Benz Manufacturing Hungary or Ford Romania. Despite the decrease in net income (nearly 33%) automobile companies increased employment by 6.5 thousand persons.

[5] Coface Ranking – Top 500 for Central and Eastern Europe

[6] Coface Ranking – Top 500 for Central and Eastern Europe

The highest sales growth was recorded in the area of car distribution, food industry and wholesale trade. The Top 500 indicated the downturn in many sectors. These were: construction, electronics, metal industry, mining industry and telecommunications. Traditionally, the economic slowdown is reflected mostly in the construction industry. 7 companies included in the list of these industries reported lower sales (-9%) and a decrease in the number of employees (-8% in 2012). Besides, the construction industry had the largest number of bankruptcies in Central and Eastern Europe.

According to the author of the analysis, development in Central and Eastern Europe is uneven, while an average annual growth remains at the level of 1.2% (compared to 5% in emerging economies). Since 2011, the bankruptcy rate increased almost threefold, and the negative trend in this regard is expected to continue also in 2013.

Adjustments to the CEE economic growth, recovery and development forecasts

A look at the region clearly shows that the countries of Central and Eastern Europe have never been so differentiated: while some of them are still struggling with recession and negative growth rate of GDP, others show steady growth. GDP per capita varies from EUR 3,000 in Ukraine to more than EUR 17,000 in Slovenia. Some countries, as the Czech Republic, were severely hit by the recession in the eurozone, while others, such as Estonia, recorded a significant growth rate. Indicators of bankruptcy rose sharply in Bulgaria and Croatia, while Estonia and Latvia show truly positive trends in this regard.[7]

In summary in accordance with the report of the NBP, the latest growth forecasts for 2013 and 2014 for the region of Central and Eastern Europe have been revised by a number of institutions down, the same applies to forecasts for almost all economies in the world. It is currently anticipated that the economic stagnation that was observed in 2012, shall extend to the whole of 2013 and a slow return to the path of relatively rapid growth will take place only in 2014.
The economies of the region shall continue to slow down as a result of the following factors: the deteriorating growth outlook for the eurozone countries, the prolonged process of deleveraging of the private sector or increasing tensions in global financial markets observed in recent months. However, the accommodative monetary policy pursued by central banks in the region, as well as the expected easing of consolidation should, at least in 2014, support the slow recovery in the region.[8]

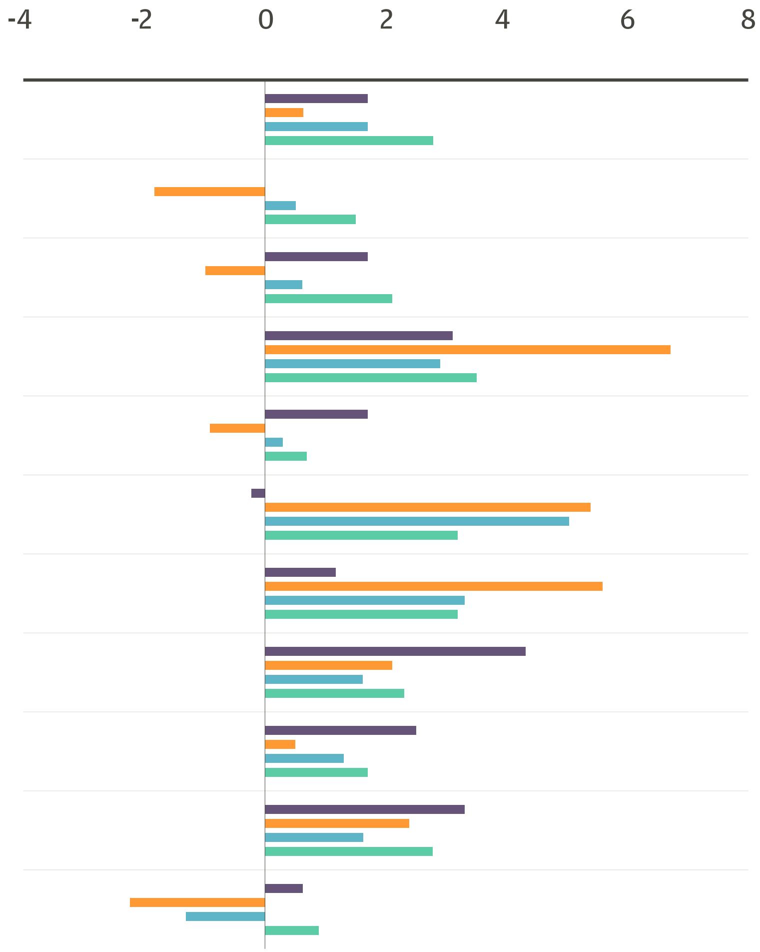
[7] Coface Ranking – Top 500 for Central and Eastern Europe

[8] National Bank of Poland, Analysis of the economic situation of the countries of Central and Eastern Europe in 2013

Real GDP

(annual variation in %):[9]

	2011	2012	2013 forecast	2014 forecast
Bulgaria	1,7	0,6	1,7	2,8
Croatia	0	-1,8	0,5	1,5
Czech Republic	1,7	-1	0,6	2,1
Estonia	3,1	6,7	2,9	3,5
Hungary	1,7	-0,9	0,3	0,7
Latvia	-0,2	5,4	5	3,2
Lithuania	1,2	5,6	3,3	3,2
Poland	4,3	2,1	1,6	2,3
Romania	2,5	0,5	1,3	1,7
Slovakia	3,3	2,4	1,6	2,8
Slovenia	0,6	-2,2	-1,3	0,9

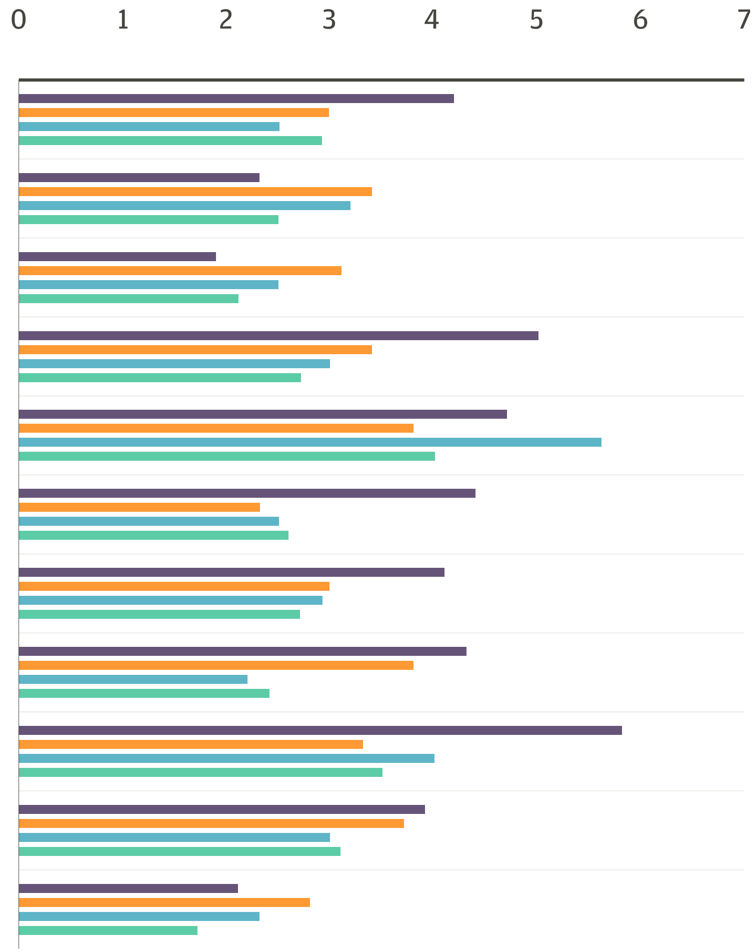


[9] Based on Consensus Economics, the EBRD, the ECB, IMF, OECD, FocusEconomics, WorldBank, UniCredit Bank Austria AG, UniCredit Research

Inflation

(variation of consumer prices in %):[10]

	2011	2012	2013 forecast	2014 forecast
Bulgaria	4,2	3	2,5	2,9
Croatia	2,3	3,4	3,2	2,5
Czech Republic	1,9	3,1	2,5	2,1
Estonia	5	3,4	3	2,7
Hungary	4,7	3,8	5,6	4
Latvia	4,4	2,3	2,5	2,6
Lithuania	4,1	3	2,9	2,7
Poland	4,3	3,8	2,2	2,4
Romania	5,8	3,3	4	3,5
Slovakia	3,9	3,7	3	3,1
Slovenia	2,1	2,8	2,3	1,7



[10] Based on Consensus Economics, the EBRD, the ECB, IMF, OECD, FocusEconomics, WorldBank, UniCredit Bank Austria AG, UniCredit Research

Łukasz Białek

Economist and manager,
he has degree in the International
Management and the MBA studies.
PhD student at the Institute of Economics
- Polish Academy of Sciences.
Interested in macroeconomics,
capital markets & commodity,
and economic policy.

Contact

Eliza Głowacka-Szprot
Managing Director
eliza.glowacka@ceedinstitute.org
CEED Institute
Krucza 24/26
00-526 Warsaw, Poland
phone (+48) 882 054 546
www.ceedinstitute.org