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The economic situation in the countries located in the region of Central and Eastern Europe

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1 The prognosis of the economic growth for the region of Central and Eastern Europe

The prognoses of the GDP growth for the region of Central and Eastern Poland in 2014 remain at the level of 1.3%. However, the institutions begin to be pessimistic in regard to the next year's predicted growth. The prognoses concerning the region have been corrected downwards and now assume the increase in GDP at the level of 1.8% in 2015.

On the other hand, European Bank of Reconstruction and Development has raised the growth prognosis for the region of Central and Eastern Europe to 2.5% from 2.2% which was forecast in May. The prognosis for the region for 2015 is 2.8%. 'A more significant growth in Poland and Hungary enhances the prospect for Central Europe.'– was said in the bank's statement in September. The most considerable upward revision refers to Hungary, for which European Bank of Reconstruction and Development raised this year's prognosis of growth from 1.6 to 2.8%. For the future down the Bank prognoses the slowdown of growth by 2.2% in regard to 1.2% which was estimated in May.

In Ukraine EBRD expects this year's decrease in GDP by 8% in relation to the decrease of 7% which was forecast in May, and the prognosis for 2015 was lowered to minus 3% from zero percent. The Bank maintains its prognosis of the zero dynamics in Russia in 2014 and has lowered the prognosis for 2015 from minus 0.2% to 0.6%.

For the sake of the comparison, as it results from the recent report issued by the National Bank of Poland and concerned with the situation of the countries of Central and Eastern Poland, the revival of those countries' economies will maintain in the next quarters of 2014 and 2015, whereas the economies of the Baltic countries are most subjected to the crisis between Russia and Ukraine. In the report published on 15th July by the National Bank of Poland and referring to the economic situation in the countries located in Central and Eastern Poland one can see that the annual growth of GDP has risen five times in a row and amounted for 2.8%. Back in the first quarter of 2013 the economies of this region were in stagnation.

The bank's experts forecast that the revival of economies in Central and Eastern European countries will maintain in the quarters to come. 'Also the structure of its growth will consolidated – the contribution of the domestic demand will rise at the cost of net export. The increase in the domestic demand should be supported by flexible fiscal and monetary policy and slightly improving situation on the job markets'. The barrier for the revival will be an ongoing process of debt reduction in the private sector. 'For the foreign demand the most serious risk might be connected with the slowdown in the Euro Zone, as well as the deterioration of the crisis in Russia and Ukraine.'

2 The GDP dynamics in the largest economies in the region

The GDP dynamics in the largest economies in the region, that is Poland, the Czech Republic, Slovakia and Hungary, has accelerated. Whereas in Bulgaria, Romania and Slovenia the growth Speer has decreased, still, it remains higher than in 2013.

The revival was accompanied by the change in the structure of growth. ‘The acceleration of the pace of economic growth is mostly thanks to a higher domestic demand, which since the fourth quarter of 2013 has started to be at the same level as the domestic demand when it comes to being the driving force in the economies of the region. It was particularly visible in the countries in which even in the first quarter of 2013 one could notice its quite serious decrease, that is the Czech Republic, Slovenia, Slovakia and Hungary. The domestic demand also accelerated in Poland, Romania, Bulgaria and Croatia. Only in the Baltic countries there was a slight slowdown.[1]

In the majority of the economies in this region, apart from the Baltic countries, the dynamics of private consumption began to rise from the beginning of the second quarter 2013 and in the first quarter 2014 it amounted for 2.4% in the annual take. The increase in the demand in households was the result of a better situation on the job market, a larger level of the actual income at one’s disposal, and the improvement in the expectations concerning the future economic situation in the countries from the region.

There has been a considerable increase in investment expenditures. ‘Starting with the second half of 2013 they have had a positive contribution on the GDP increase and it has been the first such result in almost two years. In the first quarter 2014 the annual investment dynamics amounted for 5.2% in relation to the decrease by 4.6% in the fourth quarter of 2012.

[1] National Bank of Poland, The economic situation in the countries of Central and Eastern Europe, 2014

The increase in investment expenditures was also largely due to public investment, co-financing from the funds granted by the European Union, as well as – although to a smaller extent – investments in private enterprises’.

A more significant role of domestic demand in the structure of growth

The acceleration of the pace of the economic growth in Central and Eastern European countries in 2013 and in the first quarter of 2014 is mostly the contribution of increasing domestic demand, which started to join foreign demand as the equal driving force for the economic revival. It was particularly visible in the countries in which in the previous years there had been a quite serious decrease in it, that is the Czech Republic, Slovenia, Slovakia and Hungary. The domestic demand also accelerated in Poland, Romania, Bulgaria and Croatia. In the Baltic countries the domestic demand weakened slightly, which, combined with the decrease in export, decided about the slower pace of growth in those economies. The increase in the domestic demand was the result of a less strict fiscal policy which one could observe in the majority of those countries as well as accommodative monetary policy.

Inflation in the region is rising

The region al inflation rose from 5.5% in July to 5.7% in August, driven by the highest inflation in Russia, Turkey and Ukraine. Although in September inflation in Turkey sank, he price pressure continued to rise in Russia and Ukraine. In Ukraine the limitations in the supply and higher energy costs pushed inflation to 17.5% from 0.5% at the beginning of the year. At that time the Russian Ban on fruit export from the EU in response to the Western sanctions, was driving the increase in the prices of food and will probably driver inflation to in the months to come. In the monetary policy front, almost all the banks in the region remained unchanged. Only the Central Bank of Romania decided to cut the rate of its monetary policy to the new record-low level.

The inflations expected for this year are rising, driver by the prognoses of high inflation in Russia, Turkey and Ukraine, even though the prognoses for other countries have actually been lower. The prognosis of inflation for 2014 for Eastern Europe reached 5.8% this month, which is the increase in relation to 5.6% which was forecast last month. In 2015 the decrease in the inflation to 5.0% is assumed, which is the rise by 0.2% in regard to the prognoses from the last month.[2]

According to analysts , in the recent quarters the GDP dynamics in the region has risen, although inflation remained at a low level. As has been calculated, in May 2014 the annual dynamics of HICP in the region amounted for 0.4% (in April even 0.3% in the annual take), in comparison to 0.7% in December 2013 and 4.2% in September 2012. 'It was the lowest level of inflation in the region since the beginning of the publication of HICP[3] statistics'.

It results from a variety of prognoses that from mid 2014 inflation in the Central and Eastern European region will start to rise slowly, but the scale of this growth will be less significant than it was anticipated. 'The expected rise in inflation is supposed to result, first of all, from the rising base inflation, as the effect of strengthened consumption. The prices of alimentary products and energy which triggered the decrease in the dynamics of consumption prices in 2013, in both the first and second quarter of 2014, should have a less significant influence on the formation of inflation in the next quarters'.[4]

[2] FocusEconomics Consensus Forecast

[3] HICP - harmonized index of consumer prices, calculated according to the unified methodology Statistical Office of the European Union. According to the inflation criterion in the Treaty of Maastricht, the HICP is the basis for the assessment of price stability. HICP inflation data comes from spending on household budgets and national accounts.

[4] National Bank of Poland, The economic situation in the countries of Central and Eastern Europe, 2014

[5] National Bank of Poland, The economic situation in the countries of Central and Eastern Europe, 2014

3 The conflict in the East as a threat for the growth of the countries located in the region

Currently it is geopolitical events that seem to be the most serious threat to the economic growth in the Euro Zone, which might translate into more insecurity in business and might reduce trade exchange. The recent, lower PMI readings and the indicator of moods in the European Union reflect the influence of the incidents in the Eastern Ukraine on the entrepreneurs' moods. The conflict in this part of Europe may affect the economy of the Central and Eastern European, first of all, the Baltic countries which depend strongly on export.

Economists have also estimated the sensitivity of the countries from the region to the changes in demand from Russia and Ukraine, taking Poland's sensitivity as the benchmark. 'In the case of Russia, it is definitely Baltic economies that are characterized by the highest sensitivity. In Lithuania this effect is almost 7 times, in Latvia 3.5 times, and in Estonia almost 3 times higher than in Poland. Whereas Croatia, Romania and Hungary are the countries which are relatively not too sensitive to the changes in the Russian demand. The response of the Croatian economy towards the decrease in the demand from Russia is five times lower than in Poland and over 30 times lower than in Lithuania'.[5]

Moreover, in the case of changes in the demand on Ukraine, the strongest influence would be noticed in Hungary's economy. According to the experts from the National Bank of Poland, it would be 3 times higher than for Poland, whereas in Croatia, Slovenia, and even in Estonia and Latvia, this effect would be several times weaker than in Poland.

The ongoing crisis in Ukraine continues to be the significant and crucial driving force for the deterioration of economic prospects in the region. Lower prognoses for Russia and Ukraine amount for over 90% downward adjustment of the prognoses referring to the regional economic growth in 2015.

Although the fears about the Ukrainian-Russian conflict turning into a military confrontation, have been soothed, the situation remains tense. The fights breaking out in the vicinity of Donetsk threaten a fragile truce and endanger the success of peaceful negotiations. Furthermore, analysts express their doubts and anxiety whether a peaceful understanding is enough to start a significant economic improvement this year. During the months of fights the vital infrastructure in the Eastern Ukraine has been destroyed, which needs to be rebuilt before he industrial heart of the country, can go back to its track. Additionally, the consumers' trust has reached the record lowest level in the light of the insecure political situation.

The results of the elections held on 26th October and the effect of the cooperation within the newly elected political forces, will be of vital importance for the restoration of political stability after the year of chaos, as well as for regaining trust for the institutions of the state. At the moment, the political block supporting President Poroshenko is leading in the polls, yet a considerable number of undecided electors could place small parties in the parliament, which might result in a political impasse. The experts prognosticate that the country's economy will remain in recession next year and that the economy will decrease in 0.6% in 2015, considering the expected decrease for this year, 7.3%.[6]

The conflict in Ukraine is also taking its poll on the Russian economy. While making his speech at the banking conference on 2nd October, President V. Putin tried to soothe the anxiety connected with the risk of the country's being involved in a longer period of isolation, and he also stressed that he saw the country as the part of the global economy, regardless of the sanctions imposed by the West.

President Putin also attempted to soothe the anxiety referring to the reputed alienation of Russia from the global financial system, and the fear of capital controls which the Central Bank could impose in order to cut down the flow of the capital. President V. Putin denied that there had been such plans and draw attention to financial reserves in the foreign currency and whose amount is approximately 460 billion dollars, which are sufficient to replace foreign loans.

Despite the optimistic message received from the Russian President, analysts remain insecure. Although the sanctions might be abolished immediately after the peaceful understanding with Russia, the investors' trust has been affected by the Russian intervention in the neighbouring country and will probably be rebuilt only gradually, which, therefore, will cast a shadow on the long-term economic prognoses for the country.

For 2014 economic experts prognosticate that the economic growth in Russia will amount for 0.2% and 0.7% in 2015, which is 0.3% lower in relation to the prognoses from the previous months and is the fifteenth drop in the last sixteen months.[7]

4 Central and Eastern European countries in the World Economic Forum competitiveness rank

In the latest economy competitiveness rank (Global Competitiveness Report 2014 - 2015), compiled by World Economic Forum[8], Switzerland remains the most competitive economy, whereas the second and third place are occupied by, correspondingly, by Singapore and the U.S.. The fourth place is taken by Finland and the fifth one be Germany.[9]

Global Competitiveness Report is compiled by World Economic Forum every year. Approximately 144 countries and dozen thousand companies worldwide participate in the study. The National Bank of Poland takes part in this research and is the Polish partner of WEF.

Global Competitiveness Rank used in the report is based on GCI – Global Competitiveness Index, first developed in 2004. This Index is particularly important for foreign investors who consider it to be the first stage of the selection of markets on which they will invest.
It constitutes the source of a comparative analysis.

[6] FocusEconomics Consensus Forecast

[7] FocusEconomics Consensus Forecast

[8] http://reports.weforum.org/global-competitiveness-report-2014-2015/

[9] http://reports.weforum.org/global-competitiveness-report-2014-2015/rankings/

The points granted in Global Competitiveness Report 2014-2015, according to the definition of competitiveness as 'the collection of institutions, policies and factors determining the level of efficiency in a given country', are calculated on the basis of the public and private data divided into 12 categories – in the so called competitiveness pillars which together create the complete image of competitiveness in a given country.

Below I am presenting the position of the selected countries from the Central and Eastern Europe. It is worth noticing that the leading countries have maintained a positive trend and improved their competitiveness positions in the World Economy Forum rank.

Global Competitiveness Report 2014-2015. Selected countries of the CEE region.[10]

CEE rank	Economy	Rank /144	Score	Population (millions)	GDP (US$ billions)	GDP per capita (US$)	GDP (PPP) as share (%) of world total
1	Estonia	29	4.7	1.3	24.5	19,031.94	0.03
2	Czech Republic	37	4.5	10.5	198.3	18,857.91	0.33
3	Lithuania	41	4.5	3.0	47.6	16,003.19	0.08
4	Latvia	42	4.5	2.0	31.0	15,205.42	0.04
5	Poland	43	4.5	38.5	516.1	13,394.34	0.94
6	Bulgaria	54	4.4	7.2	53.0	7,328.49	0.12
7	Romania	59	4.3	21.3	189.7	8,910.47	0.33
8	Hungary	60	4.3	9.9	132.4	13,404.83	0.23
9	Slovenia	70	4.2	2.1	46.9	22,756.02	0.07
10	Slovakia	75	4.1	5.4	95.8	17,706.20	0.15
11	Croatia	77	4.1	4.3	58.1	13,561.71	0.09

[10] http://reports.weforum.org/global-competitiveness-report-2014-2015/rankings/

The first 15 Countries ranked[11]

Economy	Rank /144	Score	Population (millions)	GDP (US$ billions)	GDP per capita (US$)	GDP (PPP) as share (%) of world total
Switzerland	1	5.7	8.0	650.8	81,323.96	0.43
Singapore	2	5.6	5.4	295.7	54,775.53	0.40
United States	3	5.5	316.4	16,799.7	53,101.01	19.31
Finland	4	5.5	5.5	256.9	47,129.30	0.22
Germany	5	5.5	80.8	3,636.0	44,999.50	3.72
Japan	6	5.5	127.3	4,901.5	38,491.35	5.40
Hong Kong	7	5.5	7.2	273.7	37,777.19	0.44
Netherlands	8	5.5	16.8	800.0	47,633.62	0.81
United Kingdom	9	5.4	64.1	2,535.8	39,567.41	2.75
Sweden	10	5.4	9.6	557.9	57,909.29	0.46
Norway	11	5.4	5.1	511.3	100,318.32	0.32
United Arab Emirates	12	5.3	9.0	396.2	43,875.93	0.31
Denmark	13	5.3	5.6	331.0	59,190.75	0.24
Taiwan, China	14	5.3	23.4	489.2	20,930.21	1.07
Canada	15	5.2	35.1	1,825.1	51,989.51	1.75

[11] http://reports.weforum.org/global-competitiveness-report-2014-2015/rankings/

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