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MOODY'S ANALYTICS CEE OUTLOOK 2014

CEE REGION'S EXPANSIONARY FISCAL POLICIES WILL INDUCE GRADUAL GROWTH IN THE COMING YEARS

LONDON/PRAGUE, 30 April 2014 — Moody's Analytics, a leading independent provider of economic forecasting, has released its latest Outlook for Central and Eastern Europe (CEE). According to the report, the CEE region is expected to grow by 2% in 2014, 3% in 2015 and 4% in 2016. This growth will arise from more relaxed fiscal policies in the region, combined with an accommodative monetary policy and ongoing euro area recovery.

These expansionary fiscal policies will result in the growth of cyclically adjusted budget deficits across most of the region, although these are likely to remain below the 3% of GDP threshold. However, budget deficits that rise above this threshold could prompt corrective measures from the European Commission (EC).

Rising volume of public debt in the CEE

Moody's Analytics estimates that this year, the volume of debt across the CEE will increase. The ratio of debt to GDP across the region is rather low, especially compared to euro area economies, where the average debt accounts for about 90% of GDP. Poland is the only country in the region where Moody's Analytics anticipates that the ratio will fall significantly, because of a winding down of the open pension funds connected to the restructuring of the pension system. Moody's Analytics economist Anna Zabrodzka says, "This one-off transfer is estimated to reduce government debt from around 58% of GDP in 2013 to about 50% this year, but it is only a stopgap. Deeper structural reforms are needed to support public finances in the long run."

Hungary and Slovenia are the outliers in region, with high public debt compared to their peers that exceeds the EU Maastricht criteria which state that the ratio should not be higher than 60% of GDP. In Slovenia, the IMF estimates that banking support measures following the crisis in Cyprus increased public debt by 12% and increased the debt-to-GDP ratio to 71.9% last year, from 54.4% in 2012.

Hungary's debt-to-GDP ratio has been around 80% for the past five years, and Moody's Analytics does not foresee a significant fall in the next decade. Furthermore, it has the highest share of foreign currency-denominated debt, which renders this debt vulnerable to exchange-rate risk. Furthermore, the country faces high short-term refinancing needs, at about 20% of GDP this year.

Strong demand for CEE government bonds

There is strong demand from foreign investors for CEE government bonds, which should boost the ability of countries in the region to raise funds for investment and spending that would benefit the region's recovery. However, excessive participation from foreign investors could pose problems if increased uncertainty were to result in high foreign capital outflows.

Risks to the forecast

"With concerns about U.S. Federal Reserve tapering subsiding, escalation of the Russia-Ukraine conflict now poses the biggest risk for emerging Europe", says Moody's Analytics economist Tomas Holinka. This could cause a spike in risk aversion that could lead to a large sell-off of CEE bonds thereby weakening government bonds and local currencies, and increasing import-price inflation.

For more information, visit Moody's Analytics Dismal Scientist.

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