CEE Economics
Q2 GDP Data

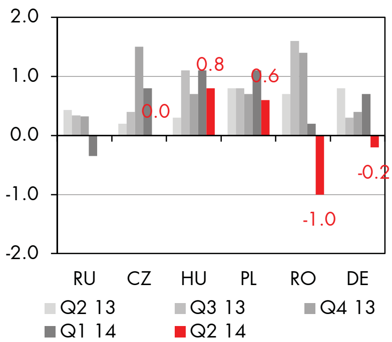
14 August 2014

Raiffeisen RESEARCH

Some moderation in Q2; downside risks going forward

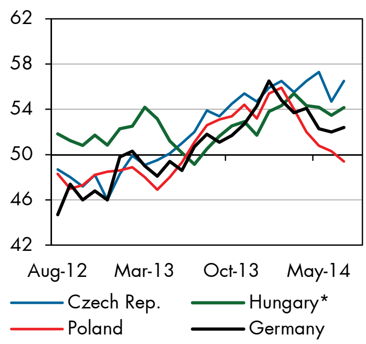
- **Hungary surprised on the upside, while Romania unexpectedly and sharply contracted**
- **Despite soft patch in German growth, CE growth momentum still present**
- **Risks for CE/SEE growth in H2 on the downside, further geopolitical escalation would hit European/CEE sentiment**
- **Russia near stagnation, modest recession if H2 deteriorates further; Ukraine in deep recession**

CEE GDP growth (% qoq)



RU - data not yet released
Source: Bloomberg, Raiffeisen RESEARCH

CE-3 and German PMIs (points)



** Hungary three month moving average*
Source: Thomson Reuters, Raiffeisen RESEARCH

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Summary

Q2 GDP data released for several CEE countries (either today or in recent days) brought both surprises to the up and downside. In some cases, like **Poland**, Q2 GDP data showed that very positive Q1 data likely marked the annual high point in quarterly yoy terms. Polish GDP growth came well in-line with our expectations for a certain softening. So, we would not see a clear link to a higher probability of a rate cut in September. Nevertheless, bets on rate cuts may still intensify as Poland is likely to be the CE country hit hardest by the current tit-for-tat sanctions between Russia and the EU (i.e. exports may weaken further and oversupply of agricultural products on the domestic market may induce additional pressure on already weak price growth).

Hungarian GDP clearly surprised on the upside, with stronger growth than anticipated rising almost at 4% yoy. That said, there are clear upside risks to our forecast of 2.7% GDP growth in Hungary in 2014. On the other hand, GDP growth in **Romania** slumped to 1.2% in yoy-terms and even sharply contracted by 1% in qoq-terms. This disappointing reading clearly implies downside risks to our forecast of GDP growth at 3.5% in 2014 (we may cut the forecast to below 3%) and may imply additional support to the real economy via outright monetary loosening or additional cuts to minimum reserve requirements.

Weaker **German** GDP growth of -0.2% qoq in Q2 (also released today) could be seen as a negative backdrop for the CE region going forward. However, one should not get too pessimistic with regard to the latest data point and also the outlook for the Germany economy (see yellow box on page 3). In general, **CE economies** do still quite fine, with yearly GDP growth rates between 2.4% and 3.9% yoy in Q2 (in Q1 the range was between 1.9% and 3.5% yoy). Stagnating quarterly growth in **Czech Republic** (released 0.0% qoq) could, in our opinion, somewhat underestimate underlying growth dynamics, while previous data points could overestimate them. However, risks for H2 are tilted to the downside. Elevated tensions and escalating trade sanctions between the West and Russia would both hurt sentiment in the euro area and in CE and SEE.

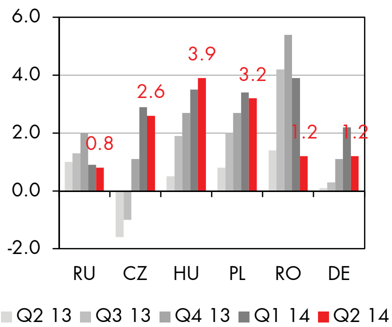
The **Russian economy** itself, showed almost stagnation with growth rates slightly below 1% yoy in both Q1 and Q2 (already released earlier). In quarterly terms, Russia's GDP contracted in Q1 and likely slightly rebounded in Q2. However, we are very cautious with regards to the outlook for H2 2014 and, therefore, keep our 2014 GDP growth forecast for the Russian economy in negative territory at -0.3% yoy. We clearly acknowledge that our forecasts for the Russian economy would need a further setback in private consumption, not only ongoing weak performance in investments, in H2 2014. In this context we want to highlight that risks to the up to now fairly solid private consumptions readings in the

CEE quarterly growth rates (% qoq)

	Q2 13	Q1 14	Q2 14
CZ	0.2	0.8	0.0
HU	0.3	1.1	0.8
PL	0.8	1.1	0.6
SI	0.2	-0.3	n.a.
SK	0.4	0.6	n.a.
CE	**0.5**	**0.9**	**n.a.**
BG	0.1	0.3	0.5
HR	-0.2	0.0	n.a.
RO	0.7	0.2	-1.0
RS	0.1	n.a.	n.a.
SEE	**0.4**	**0.2**	**n.a.**
RU	0.4	-0.4	n.a.
UA	0.4	-2.1	n.a.
CIS	**0.4**	**-0.5**	**n.a.**
CEE	**0.5**	**-0.1**	**n.a.**
TR	1.4	1.7	n.a.
DE	**0.8**	**0.7**	**-0.2**
EA	0.3	0.2	n.a.

n.a. - data not yet released
Source: Bloomberg, Raiffeisen RESEARCH

CEE GDP growth (% yoy)



Source: Bloomberg, Raiffeisen RESEARCH

CEE quarterly growth rates (% yoy)

	Q2 13	Q1 14	Q2 14
CZ	-1.6	2.9	2.6
HU	0.5	3.5	3.9
PL	0.8	3.4	3.2
SI	-1.4	1.9	n.a.
SK	0.8	2.4	2.5
CE	**0.1**	**3.1**	**2.8**
BG	0.4	1.2	1.6
HR	-0.6	-0.4	n.a.
RO	1.4	3.9	1.2
RS	0.4	0.1	-1.1
SEE	**0.8**	**2.3**	**0.8**
RU	1.0	0.9	0.8
UA	-1.3	-1.1	-4.7
CIS	**0.8**	**0.7**	**0.4**
CEE	**0.6**	**1.5**	**1.1**
TR	4.5	4.3	n.a.
DE	**0.1**	**2.2**	**1.2**
EA	-0.6	0.9	n.a.

n.a. = data yet not released
Source: Bloomberg, Raiffeisen RESEARCH

Russian economy are clearly on the rise (e.g. as indicated by deteriorating lending and deposit growth rates in the retail segment, see also our CEE Weekly as of 14 August). **Ukraine's** GDP suffers from the ongoing military conflict in the industrialized East of the country and contracted (in line with expectations) by almost 5% yoy in Q2. That said, we do not see an immediate need to touch our annual 2014 GDP "growth" forecast at -7% yoy in Ukraine.

In sum, recent **CE/SEE GDP** data do not really challenge our current growth forecasts set on aggregate. It has to be stressed that GDP growth in CE and SEE increasingly shifted to domestic demand, a reflection of a broad based recovery following a large-scale economic rebalancing. This process is unlikely to be interrupted by some moderation in exports; at least as long as an additional escalation in tit-for-tat sanctions between Russian and the EU can be avoided.

Financial Analysts: Andreas Schwabe,CFA; Gunter Deuber, RBI Vienna

Czech Republic (CZ): GDP growth optically stopped

According to the flash estimate the Czech economy stagnated in Q2 in quarter-on-quarter terms after strong jumps in Q1 2014 and Q4 2013. In year-on-year terms the economy decelerated to 2.6% in Q2 from 2.8% in Q1. Together with the market we expected a figure close to 3.0% yoy, the central bank forecasted 2.8%. Keeping in mind that we see a flash estimate, the surprise is very small. The result can be significantly revised to both sides.

Weaker outcome in Q2 stems from drop in income from the excise tax on tobacco products resulting from stocking up in the end of 2013 on the account of the Q1 and Q2 2014. But this was in fact an optical effect. In reality the underlying growth probably continued in Q2 while the growth in Q1 2014 and Q4 2013 was in fact weaker than the rude statistics suggested. On the other hand the monthly figures indicated slower growth in Q2 anyway.

The Statistical office said that "it was of a key importance for the positive development of the economy and gross value added formation that manufacturing continued in its recovery. Successful were especially manufacture of transport equipment, rubber and plastic products. On the contrary, the gross value added decreased, year-on-year, in financial service activities."

Positively, the leading indicators show the Czech economy continued in its expansion in the months to come. But the weaker figures from Eurozone and increasing geopolitical risk will reduce the potential speed of the recovery.

For 2014 we do not change our estimate of 2.6% GDP growth. Next year we foresee small deceleration to 2.4%.

Financial analyst: Michal Brozka (+420 234 401 498), Raiffeisenbank a.s., Prague

Hungary (HU): Upside surprise also helped by some one-off factors

Hungary's Q2 GDP was 3.9% (yoy) and 0.8% qoq. The data came after the already strong Q1 data (3.5% yoy) and surprised on the upside (consensus estimate was 3.5% yoy). Available high frequency data (industry, construction, retail sales, trade) displayed a fairly dynamic growth for the April-June period (but not more than in Q1) - most probably other items' (such as agriculture or the service sector) delivered the additional growth contribution.

The strong H1 performance of the Hungarian economy (+3.7% yoy) is also supported by some extraordinary or one-off factors (such as the very low base, the new capacities especially in the car industry and the massive wave public infrastructure projects typically co-financed by EU funds). As these items slowly fade away, Hungary's GDP growth dynamics is expected to slow down already by H2 2014, and even more by 2015. We believe there is an asymmetric risk to our GDP forecast (upward risk to our 2014 and downward risk to our 2015 forecast, 2.7% and 2.5% respectively)

Financial analyst: Zoltán Török (+36 1 484 4843), Raiffeisen Bank Zrt., Budapest

Please note the risk notifications and explanations at the end of this document

Focus on Germany: Weak GDP release in Q2 – Don't panic!

Today´s -0.2% qoq Q2 GDP growth figure for the German economy should be taken in a somewhat calm manner. The partly almost hysterical news coverage and the typical flutteringly chattering of many short-sighted market participants is in our opinion a bit overdone. It was clear from the beginning that Q2 would come in weak after weather effects inflated Q1 data. Nonetheless, many market observers hectically revised their 2014 GDP forecasts upwards immediately after the strong +0.8% qoq result for Q1. Now we have the same tendency in the other direction.
When to ask whether one has to revise a forecast one has to decide whether the overall picture has changed. And in the case of Germany this is not the case:

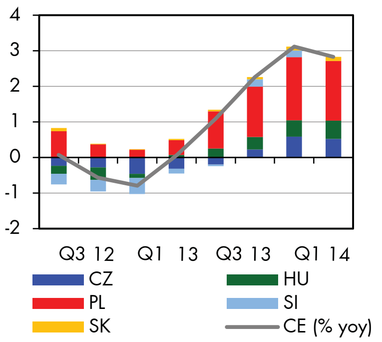
(1) We still have an ultra-loose monetary policy inside the euro area with the key interest rate and long-dated bond yields respectively around 3-4 percentage points below the level that is appropriate for the German economy;
(2) The German labour market is solid with ongoing employment gains;
(3) Important export markets for the German economy are recovering (USA, GB) or at least are not getting worse (China, euro area, CE); such effects should compensate for potential additional setback in trade with Russia (that was shrinking anyways since several months).
(4) Moreover, the fiscal stance in Germany cannot be considered as overall restrictive.

In sum, all this leads us to the conclusion that there is no reason so far to change our overall picture for the German economy for the time being.
Monetary policy will support construction investments and private consumption; rising wages and employment, expansive fiscal policy and low inflation will support private consumption; recovering export markets will support exports. So, the current dent or better the past dent (since all the negative figures actually were reported for the second quarter) is not the beginning of a prolonged downswing. It´s what it is: a dent. The current level of the PMI indices points to qoq growth in the magnitude of 0.5%. The somewhat weaker manufacturing figures are made up for by very strong services figures so far.
Taken the current GDP data - weak Q2 and downward revised Q1 - our current best guess for real GDP growth in 2014 (we forecast 0.5% qoq growth in Q3 and Q4) would be 1.6%. So that is too close to our call of 1.8% to induce a revision for the time being. Nevertheless, there is a fair chance that reciprocal sanctions between EU/Russia will have a certain dampening effect on German growth in Q3. If this is the case and figures come in closer to a level of 0.25% than at 0.5%, than our annual GDP growth forecast of 1.8% is set to be revised. This, however, would not affect the 2015 figures.
Only if there is no improvement in the conflict between Russia and the West and a spiral of even more mutual harmful sanctions, our overall picture for the German economy would be changed.

Financial analysts: Jörg Angelé, RBI Vienna

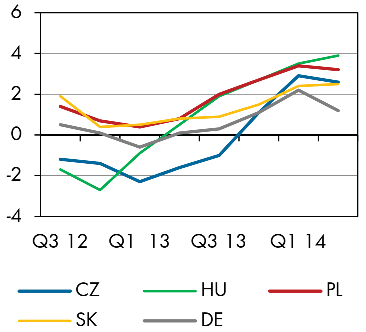
Poland (PL): Peak passed in Q1, some exposure to Russian sanctions
In line with market expectations Polish economy slowed in Q2 to 3.2% yoy from 3.4% yoy in the previous quarter.
In our opinion the growth was generated again by domestic demand. Retail sales data suggests that private consumption recovery has been continued. Dual-digit growth of investment from Q1 was hard to be maintained but construction industry performance indicates that investment activity remained high. Lower GDP dynamics was probably driven by negative net export contribution (for the first time since Q4 2010) which resulted from Ukrainian crisis, weakening euro area demand and increasing internal demand.
To sum up, the data confirmed a slight slowdown of the Polish economy as expected. However, in our opinion it should not be considered a fundamental weakness. It is worth to mention that GDP dynamics is dampened by rising basis as the recovery started in Q2 2013. Moreover, it is influenced negatively by lowering trade balance as there are disruptions in exports to Russia and Ukraine. We claim that the growth above 3% yoy does not add to arguments supporting interest rates cuts. As result we think that both today's and yesterday's data have not changed the balance of risks for Monetary Council's decisions which will still be more likely to hold interest rates unchanged.

GDP growth country contributions (pp)



Slovenia Q2 14 data yet not available
Source: Bloomberg, Raiffeisen RESEARCH

CE and DE GDP growth (% yoy)



Source: Bloomberg, Raiffeisen RESEARCH

We expect GDP growth to stabilize in next quarters above 3% yoy and the main risk for our forecast stems from Russia-Ukraine conflict. We estimate its negative effect on Polish GDP in H1 2014 of about 0.5 pp (direct impact of lower exports to Russia and Ukraine).

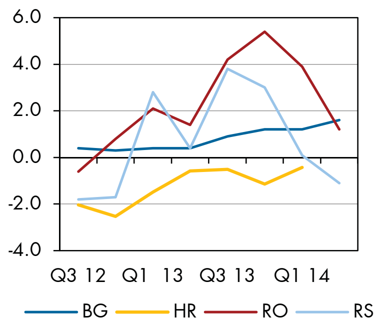
Financial analyst: Michal Burek (+48 609 921 092), Raiffeisen Polbank, Warsaw

Slovakia (SK): Q2 GDP in line with expectations with employment boom

According to the flash estimate published today, Slovak GDP growth reached a level of 2.5 % yoy in Q2 2014. The GDP figure was bit lower than our expectations (2.6%). The Slovak economy showed a slightly decelerating quarterly growth of 0.6% qoq in Q2 2014 from 0.7% in Q1 2014. The GDP release matches broader increase in economic activity in the Central European region.
The statistical office did not provide any clue on the structure of growth (details will be released on September, 3rd, 2014). However, monthly data suggests that both private consumption and industrial production has lost a bit of momentum in Q2. But both indicators have still a good moderate growth - retail sales are up by 3.3% yoy and industrial production is up by 5.5% yoy in Q2 2014. Therefore, the structure of growth should remain the same – balanced growth of all GDP components.
Total employment managed to grow for four consecutive quarters with increasing dynamics. In Q2 2014, the total employment went up by 1.5% what is rather high number given that GDP growth is "only" 2.5%. The lower productivity growth will not create much room for real wage growth in future.
In the next quarters, we expect only mild improvement in quarterly dynamic, but headline annual GDP growth should gradually accelerate towards 3% yoy in Q4 2014. The zero inflation environment pushed GDP deflator to negative territory (-0.6% in Q2 2014). Stagnating June inflation (-0.1%) and possible food price decrease due to Russia sanctions suggest that negative GDP deflator will persist longer than we thought.

Financial analyst: Juraj Valachy (+421 2 5919 2033), Tatra banka, a.s., Bratislava

SEE GDP growth (% yoy)



Source: Bloomberg, Raiffeisen RESEARCH

Romania (RO): Real GDP growth plunged in Q2

Real GDP in Q2 came in at +1.4% yoy (-1% qoq) significantly below our expectations (3.2% yoy, 0.5% qoq) and market consensus (3.4% yoy according to a Thomson Reuters Survey published on 8 August). Although the deceleration of the economic activity was already visible to some extent in quarterly dynamics of the short term indicators, the plunge in quarterly GDP came as a large negative surprise. Furthermore, data published today by Eurostat shows that quarterly dynamics in Q1 was revised downwards to -0.2% qoq from 0.2% qoq previously.
On the demand side, retail sales data (-0.1% qoq) indicated that private consumption had a poorer performance in Q2 than in Q1. After it ceased to be a main driver of growth in Q1, net export probably had a negative contribution to quarterly dynamics of GDP in Q2, as hinted by foreign trade data released at the beginning of this week.
However, all these factors are not sufficient in our view to explain such a large drop in quarterly terms (-1% qoq). Therefore, we expect that first estimates for the dynamics of GDP components in Q2 that will be released on 3 September to show a very poor performance of investments. The execution of the public budget for the first half of the year already indicated a plummet down in public investments. Private investments should have had also a poor performance in Q2, as foreign direct investments fell by -10.3% yoy in H2 2014.
On the supply side, industry probably had a positive contribution to quarterly dynamics, as industrial output advanced by +1.1% qoq in Q2. The construction sector continued to post poor performance in Q2, construction works remaining in the contraction territory for the third consecutive quarter (-1.0% qoq). Mar-

ket services rendered for population situated also in the negative territory (-1.3% qoq). Agriculture has a minor impact on GDP dynamics in the second quarter of the year.
Immediately following the release of real GDP figures in Q2, RON manifested some depreciation pressures, but these calmed down shortly afterwards. Also, yields of RON T-securities declined by several basis points, but this development should be judged in the context of poorer than expected real GDP data releases in main euro area countries.
Looking ahead, today's data seems at odds with our baseline scenario that assumed domestic demand would continue the strong performance from Q1 and the structure of growth will shift from external to internal drivers. Also, the figures notably below expectations, both in quarterly and annual terms, put at risk our annual forecast for a real GDP advance of 3.5%. After detailed data will be available, we would probably revise our forecast to below 3%. We still expect real GDP to recover in Q3 and preserve an upward trend in Q4 due, among other factors, to agricultural output which seems to have a better than expected performance. On the other hand, the central bank might continue with the easing of the monetary policy stance taking into account poor figures of real GDP growth in Q2.

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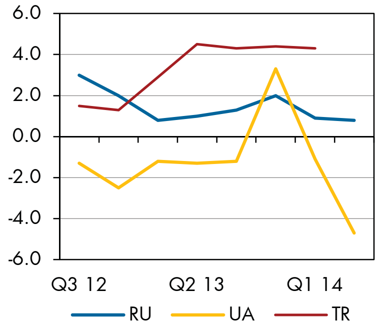
RU, UA and TR GDP growth (% yoy)



Source: Bloomberg, Raiffeisen RESEARCH

Russia (RU): Recession avoided, Q2 real GDP growth at 0.8%

According to Rosstat's first estimate, real GDP growth decelerated from 0.9% yoy in Q1 to 0.8%yoy in Q2. This figure is much lower than preliminary estimates of the Ministry of Economic Development provided in early July (+1.2%), which we considered rather optimistic. The ministry also intended to revise upward its current macro forecasts (GDP growth at 0.5% in 2014) by early autumn. However, this was before another round of sanctions against Russia and Russia`s retaliation. In seasonally adjusted quarter-on-quarter terms, according to our estimates, growth has contracted in Q1 and only slightly rebounded in Q2.
We see that deterioration in consumption dynamics is affecting growth rates at the moment. Retail sales growth decelerated from 3.6% yoy to 1.8% yoy in Q2. The sanctions against Russia cut off Russian companies from the global capital markets while cost of borrowings in RUB increases due to monetary tightening, inflation pressure, limited RUB funding capacities, etc.
Uncertainty on further developments in geopolitics and risks of new sanctions do not support investment activity either. According to our estimates, only a slower decrease of investments (from -4.8% yoy to -1.4% yoy) would allow GDP growth to remain positive for the full year. Overall, Russian growth in 2014 will be close to stagnation – even negative growth may be reached if headline growth substantially drops in H2.
As downside risks are still looming high, we prefer to stick to our conservative, below consensus forecast of GDP growth at -0.3% in 2014.

Financial analyst: Maria Pomelnikova (+7 495 221 9845), ZAO Raiffeisenbank Austria, Moscow

Ukraine (UA): Sharp drop given military conflict in the East

According to the preliminary estimate of State Statistics Service, Ukraine's GDP slumped by 4.7% yoy in Q2 2014, after 1.1% yoy decline in Q1. In the seasonally adjusted terms GDP fell by 2.3% qoq. Such negative growth dynamics looks hardly surprising, given the full-scale military conflict in the East of the country. While no detailed breakdown available yet, we might draw some conclusions based on the output dynamics data for the particular sectors of the economy. In particular, agriculture, construction and wholesale trade apparently contributed the most to the negative GDP performance in the 2nd quarter. Agricultural output growth reversed from 5.9% yoy in Q12014 to -3.9% in Q2 amid the later start of the harvesting season this year. At the same time, the output dynamics in construction and trade industries have been severely affected by the turmoil in Donbass.

We expect GDP slump to deepen in the 2nd half of the year, given the effect of military conflict in Donbass on the production base of the region. Hence, even if the sharp phase of the conflict ends soon, the economic recovery will take rather long time.

Therefore, projecting 7% yoy and 13% yoy GDP decline in Q3 and Q4 respectively, we estimate GDP growth at nearly -7% yoy for 2014 in total.

Financial analyst: Dmytro Sologub (+380 44 49590-72), Raiffeisen Bank Aval JSC, Kiev

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