Atradius

Managing risk, enabling trade

Atradius Country Reports

Central, Eastern and South-Eastern Europe – October 2018

Contents

Central, Eastern and South-Eastern European economies: Atradius STAR Political Risk Rating*:

Bulgaria:	4 (Moderate-Low Risk) - Negative
Czech Republic:	3 (Moderate-Low Risk) - Positive
Hungary:	4 (Moderate-Low Risk) - Negative
Poland:	3 (Moderate-Low Risk) – Negative
Romania	4 (Moderate-Low Risk) - Negative
Russia:	5 (Moderate Risk) - Positive
Slovakia:	3 (Moderate-Low Risk) - Positive
Turkey:	5 (Moderate Risk) - Negative

* The STAR rating runs on a scale from 1 to 10, where 1 represents the lowest risk and 10 the highest risk.

The 10 rating steps are aggregated into five broad categories to facilitate their interpretation in terms of credit quality. Starting from the most benign part of the quality spectrum, these categories range from 'Low Risk', 'Moderate-Low Risk', 'Moderate Risk', 'Moderate-High Risk' to 'High Risk', with a separate grade reserved for 'Very High Risk.'

In addition to the 10-point scale, rating modifiers are associated with each scale step: 'Positive', 'Stable', and 'Negative'. These rating modifiers allow further granularity and differentiate more finely between countries in terms of risk.

For further information about the Atradius STAR rating, please click here.

Bulgaria

Main import sources (2017, % of total)	
Germany:	12.4 %
Russia:	10.4 %
Italy:	7.4 %
Romania:	7.2 %
Turkey:	6.2 %

Main export markets (2017, % of total)	
Germany:	14.2 %
Italy:	8.8 %
Romania:	8.6 %
Turkey:	8.2 %
Greece:	6.8 %

Key indicators	2015	2016	2017	2018*	2019*
Real GDP (y-on-y, % change)	3.6	3.9	3.7	3.6	3.4
Inflation (y-on-y, % change)	-0.1	-0.8	2.1	2.6	2.5
Real private consumption (y-on-y, % change)	4.2	3.7	4.5	3.8	3.4
Real government consumption (y-on-y, % change)	0.2	2.2	2.4	1.2	1.8
Industrial production (y-on-y, % change)	2.7	2.7	3.8	1.8	2.9
Unemployment rate (%)	9.2	7.6	6.2	5.3	5.5
Real fixed investment (y-on-y, % change)	2.2	-5.1	2.5	7.0	4.5
Real exports of goods and services (y-on-y, % change)	5.7	8.0	3.8	4.1	3.9
Current account/GDP (%)	0.0	2.3	4.5	1.7	2.4
Fiscal balance (% of GDP)	-2.7	1.7	0.9	-0.4	-0.9

* forecast   Sources: Macrobond, Oxford Economics

Bulgarian industries performance outlook


Excellent:
The credit risk situation in the sector is strong / business performance in the sector is strong compared to its long-term trend.


Good:
The credit risk situation in the sector is benign / business performance in the sector is above its long-term trend.


Fair:
The credit risk credit situation in the sector is average / business performance in the sector is stable.


Poor:
The credit risk situation in the sector is relatively high / business performance in the sector is below long-term trend.


Bleak:
The credit risk situation in the sector is poor / business performance in the sector is weak compared to its long-term trend.

October 2018

Agriculture	Automotive/ Transport	Chemicals/ Pharma	Construction	Consumer Durables
				
Electronics/ ICT	**Financial Services**	**Food**	**Machines/ Engineering**	**Metals**
				
Paper	**Services**	**Shipping/ Transport**	**Steel**	**Textiles**
				

Political situation

Head of state:
President Rumen Radev
(since January 2017)

Head of government:
Prime Minister Boyko Borisov
(since May 2017)

Population:
7.0 million

Some political instability remains

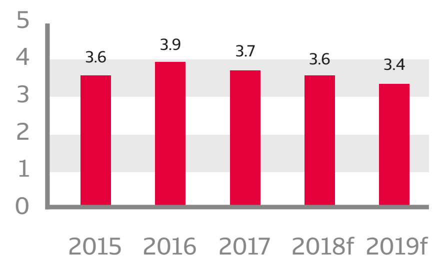
After the snap elections held in March 2017 Boyko Borisov from the centre-right GERB party became Prime Minister for the third time. He heads a coalition government of GERB and the nationalist "United Patriots" party, with just a slim majority in parliament (122 of 240 seats).

The snap elections became necessary as the previous government under Borisov had resigned after Rumen Radev, a socialist–backed pro-Russian won the November 2016 presidential elections.

Political discontent remains high, especially over the slow progress in combating graft and corruption and social welfare issues. While the incumbent government pursues a pro-EU policy, the socialist party and President Radev favour closer political and economic relations with Russia.

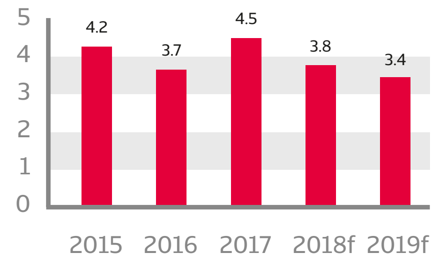
Economic situation

Real GDP growth (y-on-y, % change)



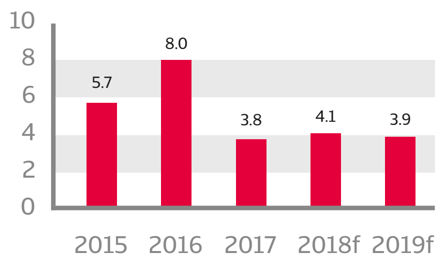
Sources: Macrobond, Oxford Economics

Real private consumption (y-on-y, % change)



Sources: Macrobond, Oxford Economics

Real exports of goods and services (y-on-y, % change)



Sources: Macrobond, Oxford Economics

Solid growth expected in 2018 and 2019

Economic growth has accelerated since 2015, driven primarily by stronger exports and growing private consumption. GDP is forecast to remain robust in 2018, as household spending is spurred by wage growth and an improving labour market (unemployment is expected to decrease to about 5.5% in 2018). At the same time investments (including EU-financed infrastructure projects) picked up again. Economic expansion is forecast to lose some momentum in 2019, but to remain strong at above 3%. Both private consumption and investment growth are expected to slow down next year.

After a surplus in 2017, the fiscal balance is expected to turn to a modest deficit in 2018 and 2019. Public debt remains sustainable (at 24% of GDP in 2019).

After a banking crisis in 2014 the sector has made big improvements, with the IMF's 2016 banking sector assessment and a stress test made by the Central Bank showing that the sector is well-capitalised and more resilient to shocks. However, more than 10% of total loans are still non-performing, which continues to be a threat to bank profitability.

Bulgaria's monetary policy framework is strong with a solid commitment to its currency board arrangement (the lev is pegged to the euro), which supports foreign investor confidence. However, this arrangement limits Bulgaria's ability to combat external imbalances. The peg is maintainable due to large international reserves (more than nine months of import cover) and current account surpluses.

Political instability remains an issue for Bulgaria´s long-term economic growth prospects, while corruption and red tape still hamper the business environment. The high level of emigration (about one million Bulgarians live abroad) and a shrinking and ageing population (the United Nations expect that Bulgaria's population will decrease from 7 million to 5.2 million by 2050) add to the woes of the labour market and reduce the potential for long-term growth.

Czech Republic

Main import sources (2017, % of total)	
Germany:	30.2 %
Poland:	9.3 %
China:	7.5 %
Slovakia:	5.9 %
The Netherlands:	5.4 %

Main export markets (2017, % of total)	
Germany:	32.8 %
Slovakia:	7.8 %
Poland:	6.1 %
France:	5.1 %
United Kingdom:	4.9 %

Key indicators	2015	2016	2017	2018*	2019*
Real GDP (y-on-y, % change)	5.4	2.4	4.5	3.1	2.8
Inflation (y-on-y, % change)	0.3	0.7	2.4	2.2	2.2
Real private consumption (y-on-y, % change)	3.7	3.5	4.0	3.2	2.9
Real government consumption (y-on-y, % change)	1.9	2.0	1.5	3.2	1.2
Industrial production (y-on-y, % change)	4.6	2.8	7.0	3.2	3.1
Unemployment rate (%)	6.5	5.5	4.2	3.3	3.4
Real fixed investment (y-on-y, % change)	10.4	-2.5	5.9	6.5	3.1
Real exports of goods and services (y-on-y, % change)	6.2	4.3	6.9	4.3	5.2
Current account/GDP (%)	0.2	1.7	1.1	1.7	0.4
Fiscal balance (% of GDP)	-1.3	1.3	-0.1	-0.3	-0.2

* forecast Sources: Macrobond, Oxford Economics

Czech Republic industries performance outlook

Excellent:
The credit risk situation in the sector is strong / business performance in the sector is strong compared to its long-term trend.

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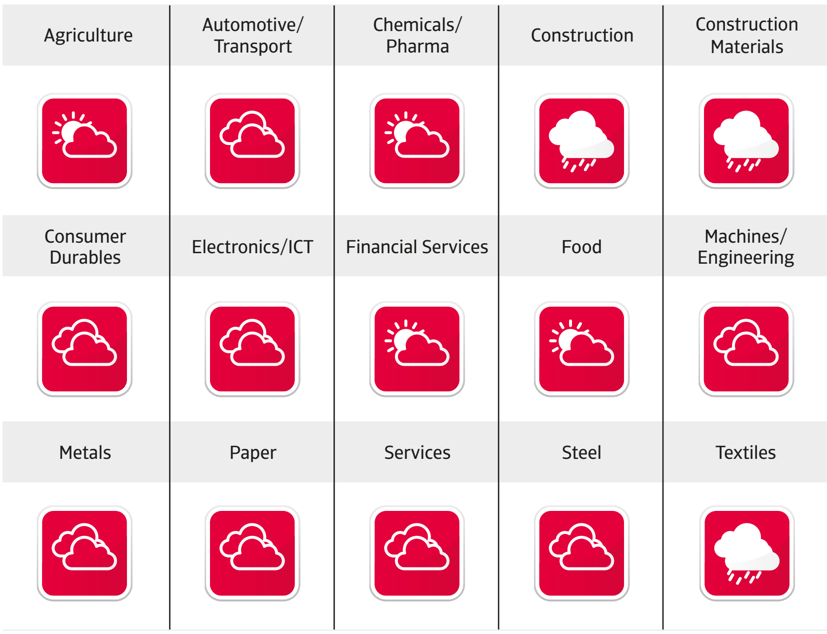
October 2018



Political situation

Head of state:
President Milos Zeman
(since March 2013)

Head of government:
Prime Minister Andrej Babis
(since December 2017)

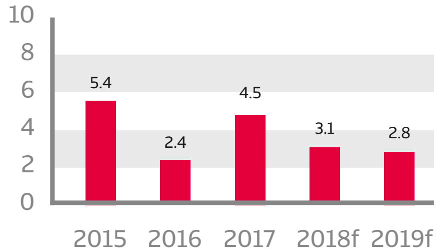
Population:
10.6 million

Minority government supported by the communist party

In the October 2017 general elections the billionaire Andrej Babis and his populist party "ANO 2011" ("Yes 2011") won the most votes. A Babis-led government lost a confidence vote in January 2018 and resigned, but remained in charge as a caretaker government. In July 2018 the administration, now consisting of a coalition between ANO 2011 and the leftist Czech Social Democratic Party (CSSD), finally won a second vote of confidence. However, still lacking a majority with only 93 seats in the 200-member parliament, it had to rely on the support of the pro-Russian Czech Communist Party, which since then has an informal role in the government – for the first time since 1989.

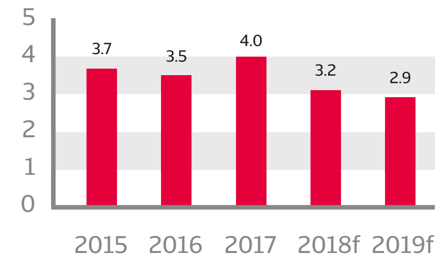
Economic situation

Real GDP growth (y-on-y, % change)



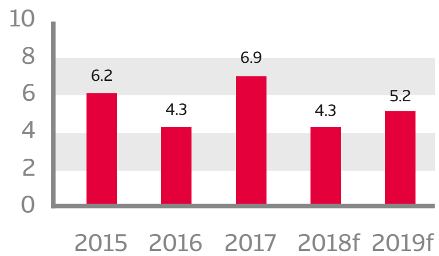
Sources: Macrobond, Oxford Economics

Real private consumption (y-on-y, % change)



Sources: Macrobond, Oxford Economics

Real exports of goods and services (y-on-y, % change)



Sources: Macrobond, Oxford Economics

Slower, but still solid growth rates expected in 2018 and 2019

After growing 4.5% in 2017 Czech GDP growth is expected to increase at a slower pace in 2018 and 2019, as eurozone and domestic demand are cooling down. However, the economic expansion is forecast to remain positive, with annual growth rates of about 3% in 2018 and 2019.

Private consumption growth has been driven by wage growth, decreasing unemployment and favourable lending conditions. In recent years export growth has been supported by the country´s improved international competitiveness. However, labour shortages are increasingly an issue, with many firms finding it difficult to fill vacancies.

In April 2017 the central bank abandoned a cap (currency ceiling level) on the koruna against the euro amid rising inflation and robust economic growth. The cap was introduced in November 2013 in order to improve the country´s competitiveness, boost exports and contain deflationary pressures. Rising inflation due to surging wages and rising house prices led to gradual increases in the benchmark interest rate, from 0.25% in August 2017 to 1.25% in August 2018.

Government finances are solid due to income growth and increased tax compliance. At 32% of GDP in 2017, government debt was low compared to other countries in the region, and is expected to decrease further. The good state of public finances means that the Czech Republic should have no troubles adhering to the adoption criteria of the euro. However, entering the eurozone still remains a controversial issue in Czech politics, with public opinion against it (in the October 2017 general elections pro-EU parties won just 40% of the votes). Therefore, a eurozone entry in the coming years seems unlikely.

Export-dependency a potential risk factor

Despite the generally benign outlook, downside risks remain. At more than 75%, the Czech Republic's export-to-GDP ratio is one of the highest in the EU, and due to foreign investment, the Czech economy is highly integrated into international value chains. This makes the country vulnerable to foreign trade losses. The main risks in this respect are rapid exchange rate appreciation hurting international competitiveness and sharp declines in external demand, e.g. triggered by increased political uncertainty (Brexit), an escalation of international trade disputes or a sudden slowdown in the eurozone.

Hungary

Main import sources (2017, % of total)	
Germany:	26.2 %
Austria:	6.3 %
China:	5.9 %
Poland:	5.5 %
Slovakia:	5.3 %

Main export markets (2017, % of total)	
Germany:	27.7 %
Romania:	5.4 %
Italy:	5.1 %
Austria:	5.0 %
Slovakia:	4.8 %

Key indicators	2015	2016	2017	2018*	2019*
Real GDP (y-on-y, % change)	3.3	2.1	4.2	4.2	2.7
Inflation (y-on-y, % change)	-0.1	0.4	2.3	3.1	3.3
Real private consumption (y-on-y, % change)	3.6	4.3	4.7	4.9	2.7
Real government consumption (y-on-y, % change)	1.1	0.8	0.3	1.1	0.0
Industrial production (y-on-y, % change)	7.0	0.8	5.5	4.4	6.5
Unemployment rate (%)	6.9	5.3	4.2	3.6	3.8
Real fixed investment (y-on-y, % change)	1.9	-10.6	16.8	13.2	4.1
Real exports of goods and services (y-on-y, % change)	8.5	3.4	7.1	3.4	3.2
Current account/GDP (%)	3.5	6.1	3.2	2.3	3.5
Fiscal balance (% of GDP)	-1.9	-1.6	-1.9	-2.6	-2.4

* forecast Sources: Macrobond, Oxford Economics

Hungary industries performance outlook

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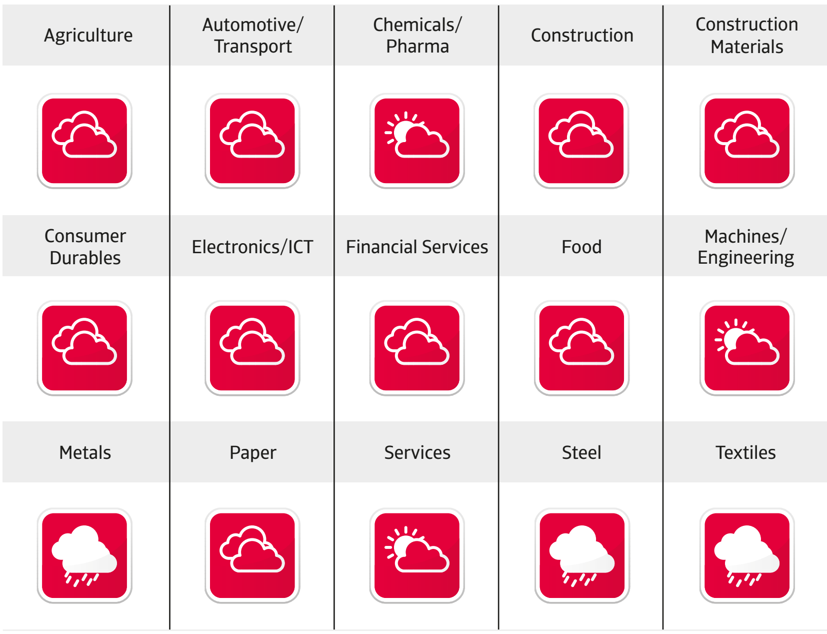
October 2018



Political situation

Head of state:
President Janos Ader
(since May 2012)

Head of government:
Prime Minister Viktor Orbán
(since May 2010)

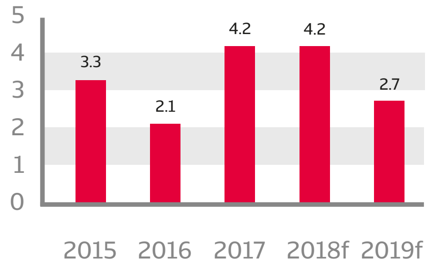
Population:
9.7 million

Troublesome relationship with the EU remains

The ruling conservative coalition of the Fidesz and KDNP parties under Prime Minister Viktor Orbán has repeatedly taken actions that led to confrontations with the EU commission and its EU peers (e.g. a controversial media law, some constitutional amendments curbing judicial independence, and a tough stance in the migrant policy, together with a lack of willingness to accept the mandatory quotas for refugees passed by the EU). Together with some unorthodox economic policy decisions like additional taxes on banks, the government's repeated confrontations with the EU have led to some uncertainty among its European peers and international investors.

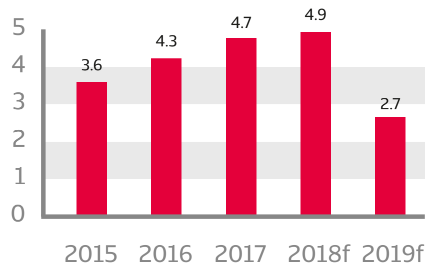
Economic situation

Real GDP growth
(y-on-y, % change)



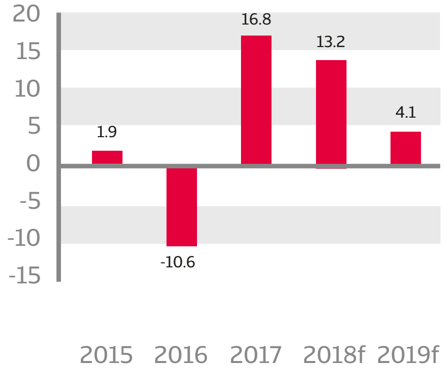
Sources: Macrobond, Oxford Economics

Real private consumption
(y-on-y, % change)



Sources: Macrobond, Oxford Economics

Real fixed investment
(y-on-y, % change)



Sources: Macrobond, Oxford Economics

Decelerating growth in 2019

In 2017 economic growth increased more than 4% as private and public investment accelerated , while private consumption and export remained robust. This momentum has continued in 2018, with growth in private consumption driven by rising wages (minimum wage increases in 2017 and 2018) and increasing employment, while investment remains solid. However, in 2019 growth is expected to decelerate to below 3% due to lower household consumption and less investment growth. Consumer prices started to rise again in 2017, and are forecast to increase above 3% in 2018 and 2019.

Containing the budget deficit to 3% of GDP is a top priority of the administration in order to avoid EU sanctions. However, since 2010 the government has been using unorthodox ways to balance the budget, most notably extraordinary taxes on banks and utilities. The budget deficit is forecast to increase in 2018 due to lower corporate taxes and social security contributions and VAT decreases. Despite annual decreases, public debt remains high at more than 70% of GDP in 2018 (Central-Eastern Europe median is 52% of GDP).

High external debt level remains a major weakness

Hungary's major weakness remains its elevated level of external debt (almost 85% of GDP in 2017), although it is expected to decrease in 2018 and 2019. A large share of this debt is foreign currency-denominated, which exacerbates the problem, as a sharp forint depreciation would hurt many Hungarian households and businesses whose loans are denominated in foreign currencies. Additionally, more than 30% of public debt is denominated in foreign currency. Despite the fact that current account surpluses bolster the exchange rate, the forint remains highly vulnerable to international investors' sentiment due to the elevated external and public debt levels and a suboptimal institutional and policy environment.

Additional risks stem from lower eurozone demand and a cooling down of world trade, which would hurt Hungarian export growth.

Poland

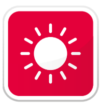
Main import sources (2017, % of total)	
Germany:	22.7 %
China:	12.1 %
Russia:	6.8 %
Italy:	5.0 %
France:	3.9 %

Main export markets (2017, % of total)	
Germany:	27.2 %
United Kingdom:	6.4 %
Czech Republic:	6.3 %
France:	5.6 %
Italy:	4.9 %

Key indicators	2015	2016	2017	2018*	2019*
Real GDP (y-on-y, % change)	3.7	2.9	4.7	4.7	3.3
Inflation (y-on-y, % change)	-0.9	-0.6	2.0	1.9	2.1
Real private consumption (y-on-y, % change)	3.0	3.7	4.7	4.1	3.6
Real government consumption (y-on-y, % change)	2.2	2.5	3.3	3.0	2.9
Industrial production (y-on-y, % change)	4.4	2.8	6.8	6.0	3.5
Unemployment rate (%)	10.5	9.0	7.3	6.2	5.9
Real fixed investment (y-on-y, % change)	6.3	-8.0	2.9	7.1	5.0
Real exports of goods and services (y-on-y, % change)	7.9	8.7	7.9	2.0	4.5
Current account/GDP (%)	-0.6	-0.3	0.2	-1.2	-1.4
Fiscal balance (% of GDP)	-2.9	-2.3	-1.6	-1.2	-1.6

* forecast   Sources: Macrobond, Oxford Economics

Poland industries performance outlook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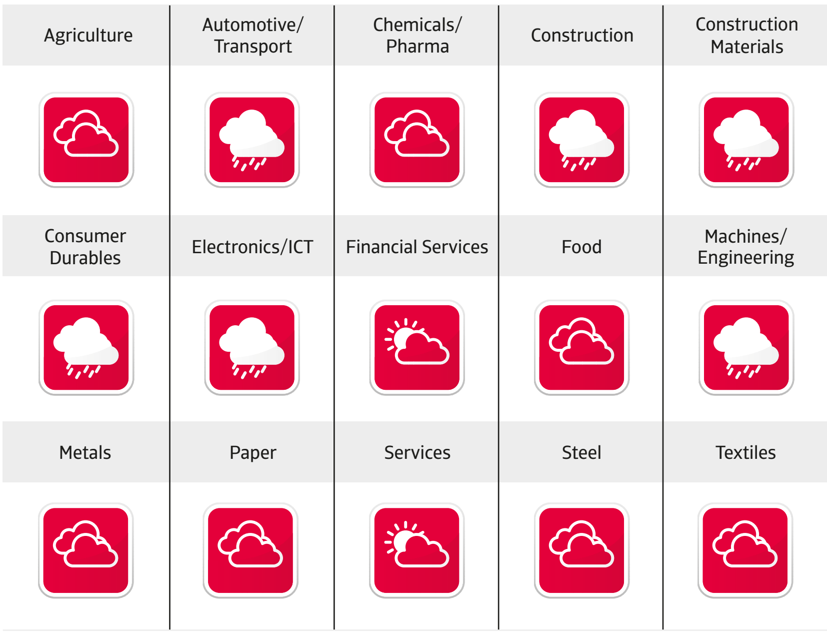
October 2018



Atradius
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Political situation

Head of state:
President Andrzej Duda
(since August 2015)

Head of government:
Prime Minister Mateusz Morawiecki
(since December 2017)

Population:
38.3 million

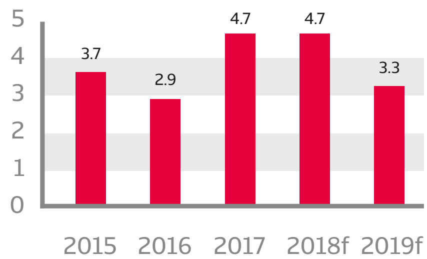
The new administration launched some controversial initiatives

The national–conservative Law and Justice (PiS) party prevailed in the October 2015 elections gaining 235 out of 460 seats in parliament. Immediately after its inauguration the new PiS-administration launched some controversial policy initiatives, such as seizing direct control of the state broadcasting channels and the security services, and purging the heads of state-owned companies. A major issue is the attempts to curb the independence of the judiciary by imposing political control over courts and the appointment of judges.

This has triggered mass demonstrations in Poland itself, while the European Commission has repeatedly warned the Polish government that such moves pose a systemic risk to the rule of law and violate EU statutes.

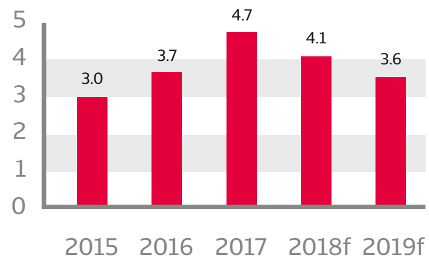
Economic situation

Real GDP growth (y-on-y, % change)



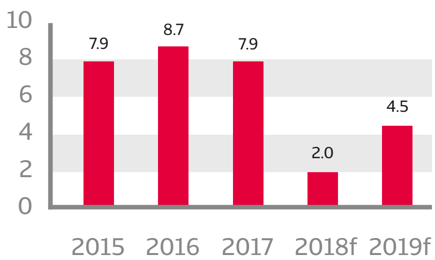
Sources: Macrobond, Oxford Economics

Real private consumption (y-on-y, % change)



Sources: Macrobond, Oxford Economics

Real exports of goods and services (y-on-y, % change)



Sources: Macrobond, Oxford Economics

Economic growth remains above eurozone average

Polish GDP growth is expected to remain well above 4% in 2018, due to robust consumer demand and increased investments. In 2019 the economic expansion is forecast to slow down somewhat, but still to remain solid (above 3%).

Private consumption growth is underpinned by increasing employment, rising wages and social transfers (e.g. a child benefit programme). At the same time public investments and disbursements of EU funds have been picking up, while export growth remains buoyant. Both business and consumer confidence remain elevated for the time being.

Following deflation in 2015 and 2016, consumer prices started to grow again in 2017, fueled by wage increases. They are forecast to remain at about 2% in 2018 and 2019. While monetary policy has been accommodative so far, given low inflation rates in the past, it is expected that the central bank will start to gradually raise interest rates by the end of 2018 in order to keep inflation within its 2% target rate.

Public debt is moderate around 50% of GDP. The government's fiscal deficit decreased in 2017 due to higher tax revenues and better tax collection. However, public spending has increased again as a consequence of a lowering of the retirement age, continued social spending and public investment.

Exposed to negative Brexit impacts

Due to the further tightening labour market, shortage of workers is increasingly becoming an issue, especially in the manufacturing sector. At the same time concerns over adverse economic and domestic policies by the Polish government remain, together with worries over the impact of external factors like US import tariffs and the Brexit decision on Polish export and investment growth.

In Central Europe, Poland's economy looks most vulnerable to the financial and economic fallout of the United Kingdom's vote to leave the EU. Annual remittances from Poles living abroad amount to about EUR 4 billion, a large share of it from the UK. In the longer term an EU departure of the United Kingdom could impact EU structural funds, which play a major role in Poland´s economic progress. The UK is also Poland´s second largest export destination after Germany.

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Romania

Main import sources (2017, % of total)	
Germany:	20.0 %
Italy:	10.0 %
Hungary:	7.5 %
Poland:	5.4 %
France:	5.3 %

Main export markets (2017, % of total)	
Germany:	23.0 %
Italy:	11.2 %
France:	6.8 %
Hungary:	4.7 %
United Kingdom:	4.1 %

Key indicators	2015	2016	2017	2018*	2019*
Real GDP (y-on-y, % change)	3.9	4.8	6.8	3.6	2.5
Consumer price (y-on-y, % change)	-0.6	-1.6	1.3	4.8	3.0
Real private consumption (y-on-y, % change)	5.8	8.0	9.9	2.9	3.8
Real government consumption (y-on-y, % change)	0.0	3.1	1.2	1.4	3.6
Industrial production (y-on-y, % change)	2.7	3.1	8.6	6.0	5.2
Unemployment rate (%)	5.1	4.8	4.2	3.6	3.9
Real fixed investment (y-on-y, % change)	7.4	-1.4	3.6	4.7	3.9
Real exports of goods and services (y-on-y, % change)	4.9	8.3	9.0	7.9	3.1
Current account/GDP (%)	-1.2	-2.1	-3.4	-3.9	-3.9
Fiscal balance (% of GDP)	-1.4	-2.3	-2.8	-4.2	-4.2

* forecast   Sources: Macrobond, Oxford Economics

Romania industries performance outlook

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Bleak:
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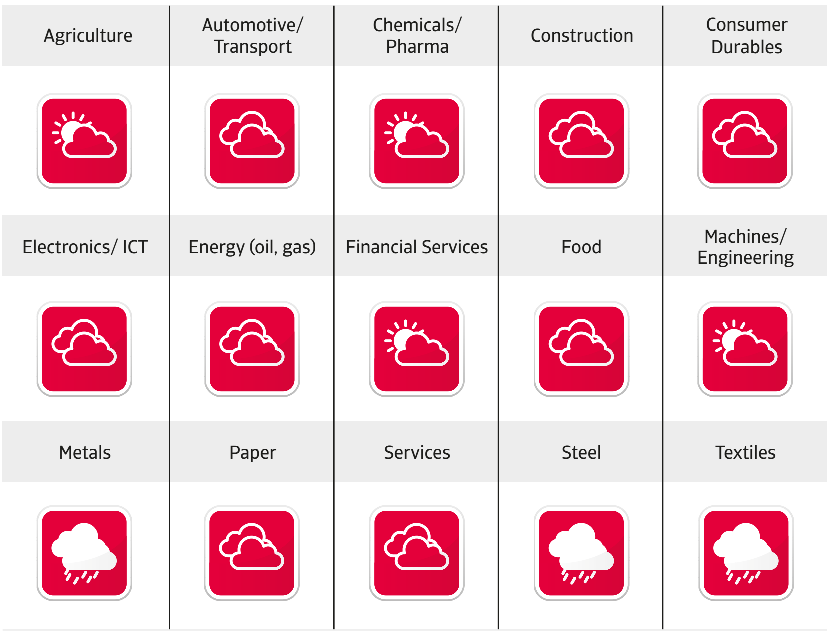
October 2018



Political situation

Head of state:
President Klaus Werner Iohannis
(since December 2014)

Head of government:
Prime Minister Viorica Dancila
(since January 2018)

Population:
19.6 million

Political uncertainty remains an issue

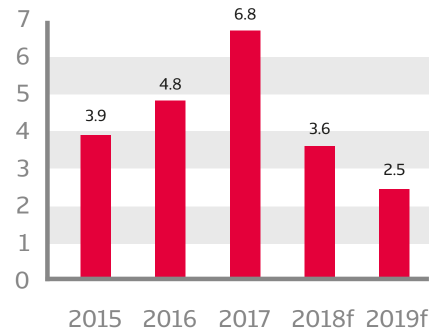
Corruption and graft remain major issues in Romanian politics and economics, and popular dissatisfaction and distrust with the political system run deep. There are regular mass demonstrations against the policies of the ruling coalition government between the social democratic PSD and the liberal ALDE party.

In June 2018 Liviu Dragnea, the powerful party leader of the PSD, was convicted for abuse of power, sentenced to more than three years of prison in the first instance. The government has repeatedly attempted to pass decrees that would decriminalise certain categories of abuse of power and corruption cases and to bring the judiciary under political control (In summer 2018 the head of the National Anticorruption Directorate DNA was dismissed on flimsy grounds at the behest of the government).

While president Iohannis tries to act as a counterweight against the government within the boundaries of his constitutional powers, the government has threatened to initiate impeachment proceedings against him.

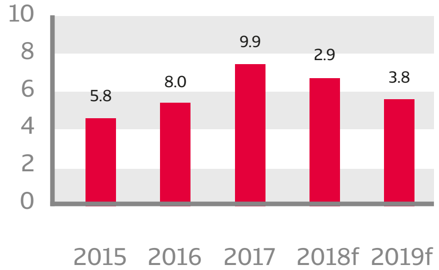
Economic situation

Real GDP growth
(y-on-y, % change)



Sources: Macrobond, Oxford Economics

Real private consumption
(y-on-y, % change)



Sources: Macrobond, Oxford Economics

Lower, but still solid growth expected in 2018 and 2019

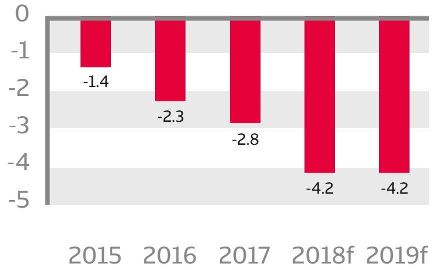
Romania has shown robust GDP growth rates over the last couple of years, mainly driven by surging domestic demand. In 2017 economic growth increased almost 7%, mainly due to robust 10% growth in private consumption, helped by low interest rates, rising wages and decreasing unemployment.

GDP is expected to grow at a lower pace in 2018 and 2019, as domestic demand is cooling down. This slowdown is also due to interest rate increases since early 2018 in order to combat rising inflation and to slower export growth, as demand from the eurozone has weakened.

The Romanian banking sector has continued its trend of substantial improvement in 2016, with rising capital adequacy ratios and decreasing non-performing loans. However, the sector is still subject to elevated credit risk due to foreign exchange mismatches and low credit growth.

The budget deficit increased in 2016 and 2017 due to a VAT reduction and the expansion of public spending in the run-up to the November 2016 general election. In 2018 and in 2019 the deficit is expected to increase further due to the continuation of expansive fiscal policies. This leaves the government budget more dependent on a positive economic outlook, and there is still an urgent need for improving tax administration. However, at about 38% of GDP public debt remains moderate.

Fiscal balance (% of GDP)



Sources: Macrobond, Oxford Economics

Vulnerable to international investor sentiment

Romania remains exposed to some major vulnerabilities. Red tape and corruption still hamper the economic development. The current account deficit has increased again above 3% of GDP in 2017 and is expected to increase further in 2018 and 2019 due to elevated import demand. At the same time the currency is subject to some volatility, and the country remains vulnerable to capital outflows should there be adverse internal (e.g. a major political unrest) and/or external developments. However, at the same time there are some solid buffers in place – abundant international reserves (more than five months of import cover), low public debt and a flexible exchange rate.

Russia

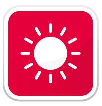
Main import sources (2017, % of total)	
China:	21.2 %
Germany:	10.0 %
USA:	5.6 %
Belarus:	5.0 %
Italy:	4.3 %

Main export markets (2017, % of total)	
China:	10.8 %
The Netherlands:	9.9 %
Germany:	7.2 %
Belarus:	5.4 %
Turkey:	5.1 %

Key indicators	2015	2016	2017	2018*	2019*
Real GDP (y-on-y, % change)	-2.5	-0.2	1.5	1.8	1.5
Inflation (y-on-y, % change)	15.5	7.0	3.7	3.0	4.3
Real private consumption (y-on-y, % change)	-9.3	-2.8	3.3	3.1	2.7
Real government consumption (y-on-y, % change)	-3.1	0.9	0.4	0.4	0.6
Industrial production (y-on-y, % change)	-2.1	3.1	2.2	1.5	0.3
Unemployment rate (%)	5.6	5.5	5.2	5.0	5.2
Real fixed investment (y-on-y, % change)	-11.2	0.9	4.3	1.2	1.5
Real exports of goods and services (y-on-y, % change)	3.7	3.1	5.1	5.1	2.3
Current account/GDP (%)	5.1	2.0	2.3	6.7	7.7
Fiscal balance (% of GDP)	-3.3	-3.5	-1.3	-0.6	-0.7

* forecast Sources: Macrobond, Oxford Economics

Russia industries performance outlook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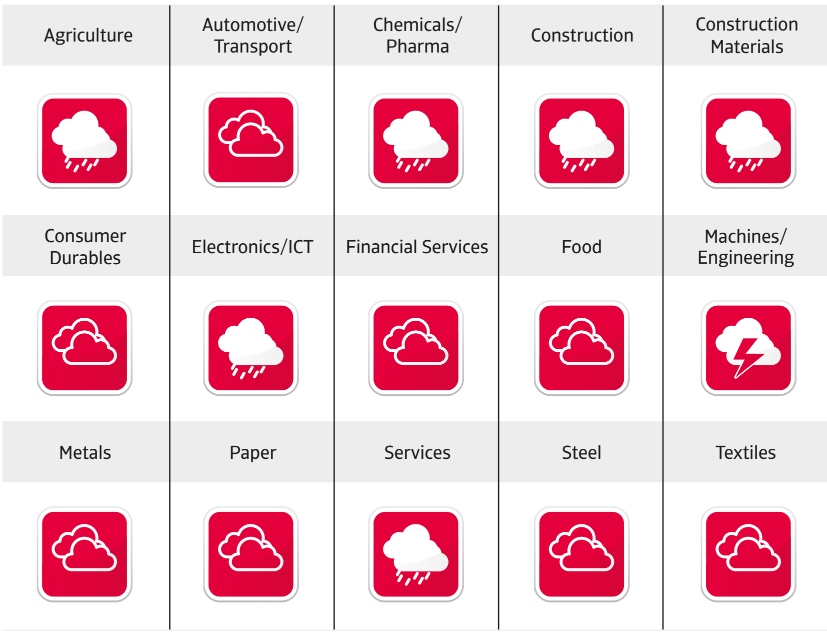
October 2018



Political situation

Head of state:
President Vladimir Putin
(since May 2012)

Head of government:
Prime Minister Dmitry Medvedev
(since May 2012)

Form of government:
Government formed by the Party United Russia and non-partisan technocrats

Population:
147.0 million

Domestic politics: continued stability - but at the expense of democracy

In March 2018 Vladimir Putin won a fourth term as president of Russia, gaining 77% of the vote. Nationalistic sentiment has risen since the outbreak of the Ukraine crisis and the annexation of Crimea in 2014, supported by aggressive propaganda through the state-controlled media. However, approval ratings for the government have recently decreased to pre-2014 levels, following the administration´s announcement to increase the pension age.

Any opposition has been marginalised by a hardening of authoritarianism: hardliners have effectively been given license to attack liberals and crack down further on independent media and non-governmental organisations.

Relationship with the EU and the US remains tense

Since the outbreak of the Ukraine crisis in early 2014 the relationship between Russia and the EU and US has gradually deteriorated. Russia´s intervention in the civil war in Syria added another area of conflict to the already strained relationships.

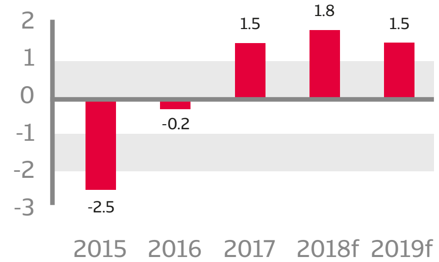
Moscow´s annexation of Crimea in March 2014 and its tacit support of separatist forces in Eastern Ukraine triggered several rounds of sanctions from the EU and the US, mainly in the form of

- frozen assets,
- travel bans on Russian and Crimean individuals,
- long-term financing limitations restricting access to EU/US capital markets for major Russian banks and some oil and defense businesses
- and restrictions on the export of certain types of products to Russia, including dual-use technologies and high-tech equipment for the oil industry.

Russia itself imposed retaliatory sanctions on the import of food and agricultural products from the EU, the US, Australia, Canada and Norway. In March 2018 tensions increased further after the alleged nerve gas attack by the Russian secret service on a former spy in the UK, leading to additional sanctions imposed by the UK and the US in 2018.

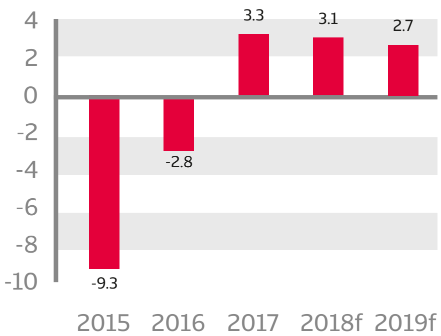
Economic situation

Real GDP growth (y-on-y, % change)



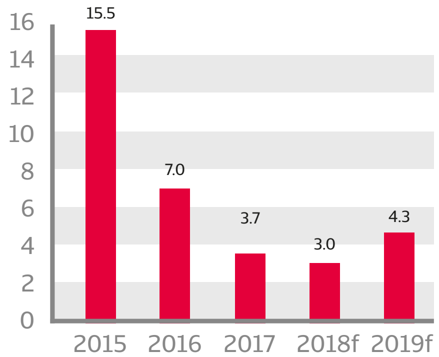
Sources: Macrobond, Oxford Economics

Real private consumption (y-on-y, % change)



Sources: Macrobond, Oxford Economics

Inflation (y-on-y, % change)



Sources: Macrobond, Oxford Economics

A modest economic rebound, but downside risks remain

Annual GDP grew again in 2017 after two years of contraction, and the recovery is set to continue in 2018 and 2019, mainly based on the rebound in oil prices and stronger domestic demand.

However, structural weaknesses and the negative impact of sanctions on productivity and investment continue to weigh on economic expansion. Major short-term downside risks to the growth outlook are increased exchange rate volatility and rising inflation in the wake of further rising geopolitical tensions and the newly imposed sanctions. In August 2018 the US imposed additional sanctions as a reaction to the nerve gas incident in the UK, including a ban on exports to Russia of security-sensitive goods and technology, and more sanctions like increased curbs on trade are looming.

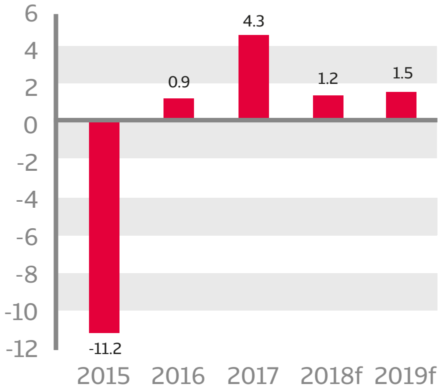
Private consumption growth is likely to remain robust in the coming months, driven by higher consumer confidence and a lower inflation rate boosting real disposable income. Russia has seen a steady decline in consumer price inflation since late 2015, which allowed the Central Bank to cut its main policy rate several times, to 7.25%. Further monetary easing to support growth is expected in the mid-term. However, real fixed investment growth is expected to remain subdued in 2018 and 2019 due to the high level of perceived risk, red tape and a weak institutional backdrop.

The Russian banking sector has slowly recovered in 2017 and H1 of 2018 and the Central Bank's interventions to bail out Otkritie and B&N bank have prevented a systemic crisis. However, the launch of new US sanctions against Russian oligarchs and their companies threatens to derail the recovery, through uncertainty and lower investment. The EU/US sanctions may have a very significant mid- and long-term impact on the refinancing capacity of major domestic corporations and banks.

The Central bank allows the rouble to float. This has an impact on inflation if the currency depreciates, but also acts as a shock absorber for the current account, which is expected to remain in surplus in 2018 and 2019. At the same time, the fairly large international reserve position of Russia hardly erodes as capital outflows are contained.

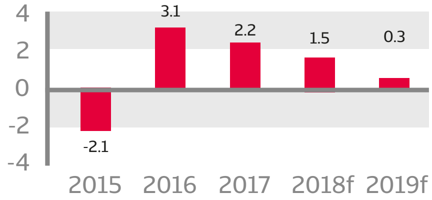
Russia´s short-term economic policy during the previous recession has been rather prudent. Despite very low public debt of about 12% of GDP and pressure from low oil prices on the budget, the government deficit has been kept within acceptable margins. In order to shore up state finances for higher social spending in the coming years the government plans to increase the value-added tax from 18% to 20% as of January 2019 and has raised the pension age.

Real fixed investment (y-on-y, % change)



Sources: Macrobond, Oxford Economics

Industrial production (y-on-y, % change)



Sources: Macrobond, Oxford Economics

The government has confirmed its plans to balance the budget by 2020, using a fixed USD 40 per barrel oil price. Any extra revenue generated by a higher oil price will be used to intervene in the currency market and to further build up currency reserves. This build-up of foreign reserves is allowing Russia to avoid reliance on borrowing and to pursue a more independent economic policy.

Major structural weaknesses weigh on the long-term growth prospects

Despite the on-going economic rebound, the long-term prospect for higher and sustainable growth rates remains subdued, as structural weaknesses and the negative impact of sanctions on productivity and investment will continue to weigh on growth.

The Russian business climate is mired in uncertainty regarding property rights, a weak transport infrastructure and lack of competition in goods and services markets. The authorities failed to seize the opportunity during the windfall years to strengthen Russia's economic structure and enhance its non-oil potential by prudently investing high oil revenues in other industries to diversify the economy away from the dominant oil and gas sector.

There is an underlying deterrent for investments, badly needed to modernise the energy sector and help to diversify the economy. Even before the outbreak of the Ukrainian crisis, the investment level was too low and foreign direct investment too limited, partly due to an unfriendly business climate and the firm grip of the state on large parts of the economy. This is now exacerbated by the international sanctions imposed by the EU and the US that aim to prevent technology transfers and financing to Russian firms, especially in the energy and military sectors.

Slovakia

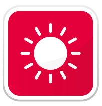
Main import sources (2017, % of total)	
Germany:	19.1 %
Czech Republic:	16.2 %
Austria:	10.3 %
Poland:	6.5 %
Hungary:	6.4 %

Main export markets (2017, % of total)	
Germany:	20.7 %
Czech Republic:	11.6 %
Poland:	7.7 %
France:	6.3 %
United Kingdom:	6.1 %

Key indicators	2015	2016	2017	2018*	2019*
Real GDP (y-on-y, % change)	3.9	3.3	3.4	3.2	2.5
Inflation (y-on-y, % change)	-0.3	-0.5	1.3	2.8	2.2
Real private consumption (y-on-y, % change)	2.2	2.7	3.6	3.2	2.4
Real government consumption (y-on-y, % change)	5.4	1.6	0.2	1.8	1.9
Industrial production (y-on-y, % change)	6.1	3.8	2.9	4.3	4.4
Unemployment rate (%)	11.5	9.7	8.1	7.0	7.3
Real fixed investment (y-on-y, % change)	19.8	-8.3	3.2	5.5	3.8
Real exports of goods and services (y-on-y, % change)	6.4	6.2	4.3	4.1	4.6
Current account/GDP (%)	-1.7	-1.4	-2.1	-2.0	-1.9
Fiscal balance (% of GDP)	-2.5	-1.2	-1.4	-1.4	-1.2

* forecast   Sources: Macrobond, Oxford Economics

Slovakia industries performance outlook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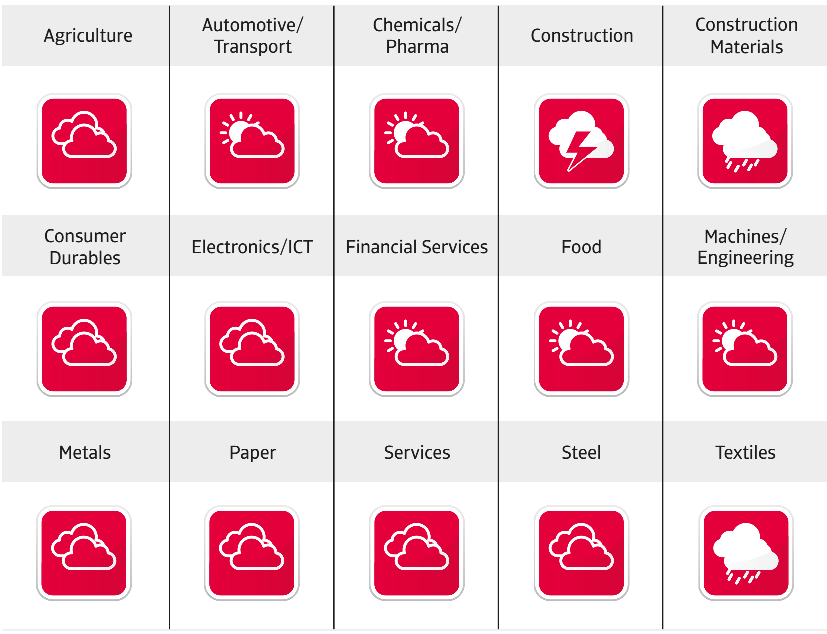
October 2018



Political situation

Head of state:
President Andrej Kiska
(since June 2014)

Head of government:
Prime Minister Peter Pelligrini
(since March 2018)

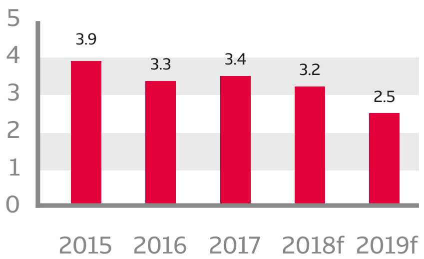
Population:
5.5 million

Increased political uncertainty

Having served as Prime Minister for ten of the past 12 years, in March 2018 Robert Fico resigned after mass demonstrations against his government. The protests were triggered by the assassination of a journalist who was investigating alleged links between the administration and organised crime as well as cronyism within the governing social-democratic Smer-SD party. After Fico´s resignation it seems that the current coalition government (consisting of the Smer-SD, the nationalist SNS party and the liberal conservative Most-Híd party) is stable enough to remain in charge for the time being. However, any further revelation of corruption allegations and power abuse could lead to increased political instability and a snap election. Next general elections are due to be held in March 2020.

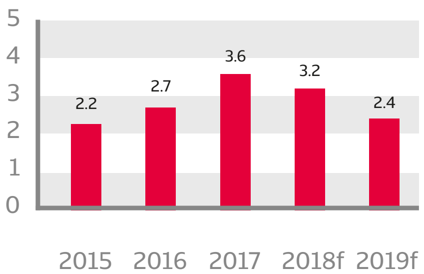
Economic situation

Real GDP growth (y-on-y, % change)



Sources: Macrobond, Oxford Economics

Real private consumption (y-on-y, % change)



Sources: Macrobond, Oxford Economics

Growth is forecast to remain robust in 2018

Despite increased political challenges the Slovakian economy is poised to continue on its robust growth path in 2018, driven by continued robust domestic demand, surging investment and exports to the eurozone. In 2019 growth is forecast to decelerate somewhat, down to about 2.5%

Private consumption is forecast to continue to be one of the primary drivers of the economic expansion, supported by wage increases and growing employment. The unemployment rate has decreased from 14% in 2013 to 8% in 2017, and a further decline in 2018 is expected. Inflation forecast to stay at about 2% in 2018 and 2019, allowing real wage growth to continue.

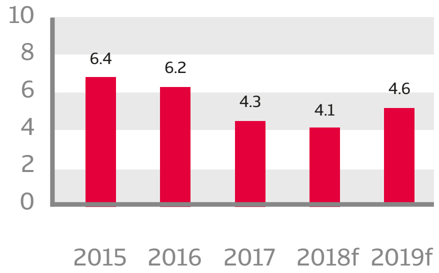
Investment growth is driven by EU funds, an increasing number of public-private partnership financed projects and the construction of a new Jaguar Land Rover plant. However, inefficient drawdown of EU funds limits even higher increases.

Exports are expected to grow more than 4% annually in 2018 and 2019, mainly driven by the favourable outlook of the automotive industry and persisting eurozone demand (notably from Germany). Large foreign investments have increased productivity and export opportunities.

The Slovakian banking sector is generally well-capitalised with strong liquidity, and the rate of non-performing loans has decreased since 2014. This reduces the risk of a negative shock from the current high domestic credit growth, which has been increasing faster than nominal GDP since 2015.

Government finances are stable, with the budget deficit being kept below 3% of GDP since 2013. The deficit is expected to be kept around 1.5% of GDP in 2018 and 2019. Slovakia´s external economic position is solid.

Real exports of goods and services (y-on-y, % change)



Sources: Macrobond, Oxford Economics

High dependence on automotive poses a potential downside risk

As the Slovakian economy is heavily reliant on industrial exports (especially automotive related) to the Eurozone, Germany in particular, it remains very vulnerable to a eurozone downturn and/or adverse developments in the automotive sector, such as potential US tariffs on car and car part imports from the EU. This would increase the credit risk of Slovakian businesses along the value chain.

Other issues are increasing labour shortages and disadvantageous demographics (a shrinking working age population), which adversely affect Slovakia´s medium- to long-term growth prospects.

Turkey

Main import sources (2017, % of total)	
China:	10.0 %
Germany:	9.1 %
Russia:	8.3 %
USA:	5.1 %
Italy:	4.8 %

Main export markets (2017, % of total)	
Germany:	9.6 %
United Kingdom:	6.1 %
Iraq:	5.8 %
UAE:	5.8 %
USA:	5.5 %

Key indicators	2015	2016	2017	2018*	2019*
Real GDP growth (y-on-y, % change)	6.1	3.2	7.4	3.9	1.2
Inflation (y-on-y, % change)	7.7	7.8	11.1	15.0	21.7
Real private consumption (y-on-y, % change)	5.4	3.7	6.1	4.4	-2.9
Real government consumption (y-on-y, % change)	3.9	9.5	5.0	3.1	2.4
Industrial production (y-on-y, % change)	6.1	3.4	8.9	4.3	2.4
Unemployment rate (%)	10.3	10.9	10.9	10.4	10.2
Real fixed investment (y-on-y, % change)	9.3	2.2	7.3	2.6	0.3
Real exports of goods and services (y-on-y, % change)	4.3	-1.9	12.0	7.6	14.3
Current account/GDP (%)	-3.8	-3.9	-5.5	-8.1	-3.4
Fiscal balance (% of GDP)	-1.0	-1.2	-1.6	-2.6	-1.9

* forecast Sources: Macrobond, Oxford Economics

Turkey industries performance outlook

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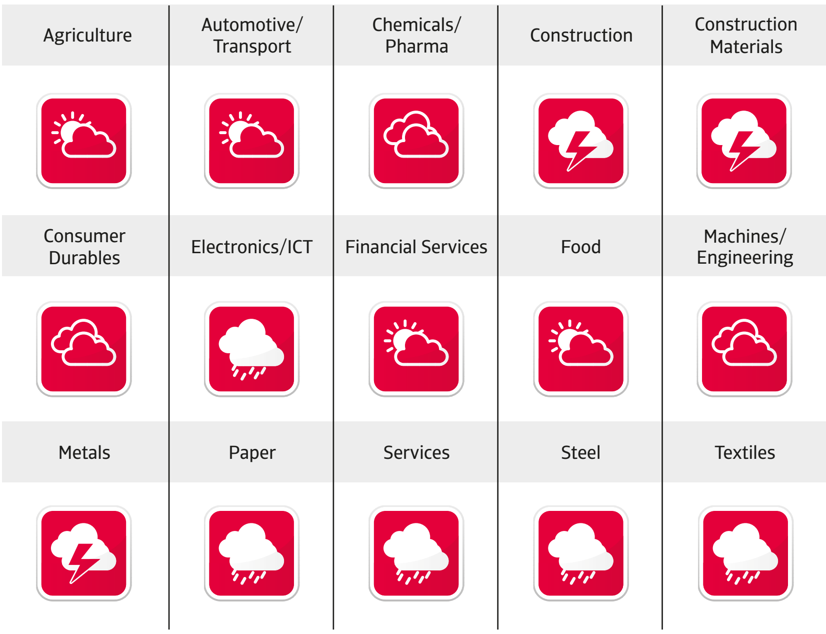


Political situation

Head of state/government:
President Recep Tayyip Erdogan (since August 2014)

Nature of regime:
Presidential system and secular state. The armed forces´ political influence has been curbed.

Population:
81.9 million

President Erdogan has further consolidated his power

President Erdogan won the June 2018 presidential elections in the first round, finally consolidating his overwhelming power, as with this voting the transition to the new presidential system has been completed. Former constitutional checks and balances have been abolished and government leverage on formally independent institutions such as the Central Bank and the judiciary has increased. In the June 2018 parliamentary elections the alliance of Erdogan´s AKP with the nationalist MHP party won 53.7% of the votes.

The serious political divisions within the country persist, and the crackdown to purge officials suspected of having links to the failed July 2016 coup and the Gülen movement have continued. So far, more than 150,000 people (including military, police, judges, prosecutors, journalists, civil servants, etc.) have been suspended, dismissed or arrested. The rule of law and the human rights situation are further deteriorating. Businesses could get a trustee assigned in their management to oversee their business.

The southeastern part of the country remains affected by the civil war in Syria and cross-border interventions by the Turkish army. Fighting between Turkish forces and the Kurdistan Workers´ Party (PKK) has flared-up again after Ankara ended a two-year ceasefire and terminated informal peace talks with the PKK in 2015. The risk of terrorist attacks remains elevated.

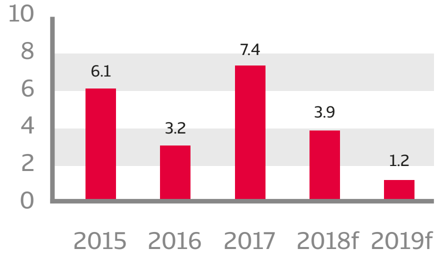
Relationships with Western partners have deteriorated

Relations with the EU and some major members (especially Germany) remain strained over criticism of the curbing of the rule of law and democracy in Turkey and the detention of journalists and human rights activists with EU-citizenship.

Relations with the US have deteriorated since August 2018, as Washington doubled punitive tariffs on Turkish steel and aluminium imports after Turkey's refusal to extradite a US pastor charged with espionage and support of terrorism. The relationship has already been tense before this event, due to Washington´s refusal to extradite Gülen and the US supplying arms to the Kurdish People's Protection Units for their fight against IS.

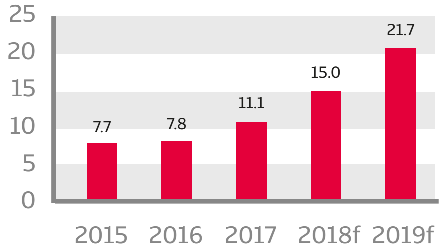
Economic situation

Real GDP growth (y-on-y, % change)



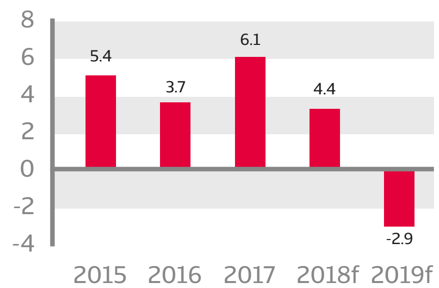
Sources: Macrobond, Oxford Economics

Inflation (% of GDP)



Sources: Macrobond, Oxford Economics

Real private consumption (y-on-y, % change)



Sources: Macrobond, Oxford Economics

Risk of a severe downturn has increased

Economic growth increased more than 7% in 2017, mainly due to a comprehensive government stimulus package that consisted of tax breaks, employment incentives and credit support measures. However, economic imbalances have increased since then. The composition of growth during the recent boom period indicates over-reliance on private consumption and investment in the construction sector. Inflation remains stubbornly high and has sharply increased to almost 18% in August 2018, far above the central bank target of 5%. Due to the credit-driven growth (mainly externally funded, given Turkey's low savings rate) the current account deficit has risen sharply in 2017 and H1 of 2018.

Heightened geopolitical uncertainty, deterioration in institutional quality, an increase in the corporate tax rate from 20% to 22% in 2018 and a low priority on structural reforms are all casting a shadow over Turkey's business investment climate. Lack of investment, in turn, constrains productivity growth and export capacity. The risk of a hard landing has sharply increased, mainly due to the sharp depreciation of the lira and the threat that capital inflows are drying up.

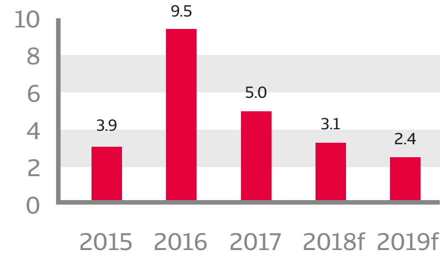
Since January 2018 the lira has lost about 40% of its value against the USD and the euro. Lira depreciation accelerated following the escalation of a row with the US over the detention of a US pastor in August 2018.

However, the main reasons for currency volatility lie deeper: the lira came under massive pressure after President Erdogan repeatedly voiced his unorthodox view that high interest rates cause high inflation and that he will take more control over the monetary policy. This fueled doubts of financial markets about central bank independence resulting in high pressure on the Turkish currency since early 2018. Turkey's low-savings economy is very vulnerable to capital outflows because a large part of the current account deficit is financed by short-term and volatile portfolio capital inflows, which have been negatively affected by the current issues. Foreign reserves are declining and insufficient to cover the external financing requirements.

The situation stabilized somewhat in mid-August 2018 after steps were taken to tighten monetary supply and to limit swap transactions in order to protect the currency against short-selling. Additionally, Qatar announced financial support (USD 15 billion of foreign direct investment and a USD three billion currency swap). Finally, in September 2018 the Central Bank increased its benchmark interest rate from 17.75% to 24%, a hike of 625 basis points, which exceeded market expectation and has led to a stabilisation of the exchange rate - for the time being. That said, the high interest rates will have an adverse effect on economic growth in 2018 and 2019. In combination with a sudden stop in capital inflows, this could result in a credit crunch.

Despite monetary tightening the economy remains susceptible to further currency volatility, due to tighter global liquidity conditions, ongoing tensions with the US and the large share of foreign currency denominated corporate debt. The level of external debt, which is mostly held by the private sector (banks and corporations) is high (amounting to USD 220 billion, more than 200% of exports goods and services) and debt is sensitive to interest rate, rollover and exchange rate risks. In case of a permanent real depreciation of the lira of 30%, debt would exceed 80% of GDP by 2023.

Real government consumption (y-on-y, % change)

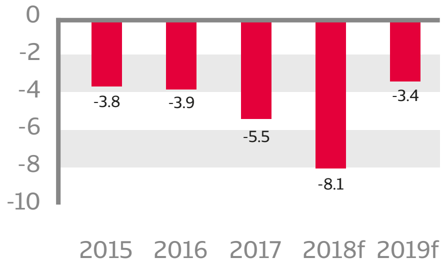


Sources: Macrobond, Oxford Economics

Non-financial companies in particular run a substantial currency risk with about half of their total loans (close to 70% of GDP) being denominated in foreign currency, while foreign exchange (FX) assets only cover about 40% of FX liabilities. Turkish corporates particularly in the energy, construction materials, steel, transport (airlines) and chemicals sectors have extensively borrowed in foreign currency from local banks.

Although a substantial share of this debt is either financially hedged or is held by companies with a natural hedge (e.g. via export revenues), some companies – particularly SMEs but also large corporations – are poorly hedged. This is evidenced by a number of Turkish companies that have recently sought debt restructuring. To address this, the central bank introduced measures to restrict FX borrowing by SMEs without natural hedges. In some major industries payment behaviour has already deteriorated, with extended payment terms and an increased number of payment delays. Turkish business insolvencies remain on an elevated level, with 80% of newly established businesses failing in the first three years. It is expected that business insolvencies will increase, especially in the property, construction and energy sectors.

Current account (% of GDP)

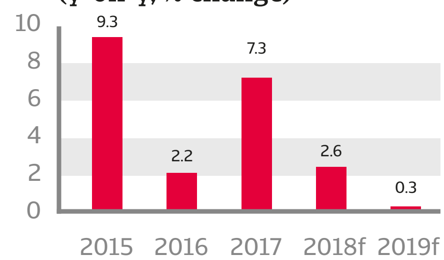


Sources: Macrobond, Oxford Economics

The Turkish banking sector has hitherto been generally well regulated and capitalized. However, banks could be severely affected by continued lira depreciation: Either via higher non-performing corporate sector loans or difficulties refinancing the substantial amount of short-term FX funding that Turkish banks rely on to extend domestic credit. The high lira loan-to-deposit ratio of 148% in 2017 emphasizes the high reliance of banks on external market funding. Turkish commercial banks hold around USD 102 billion of short-term external debt. Therefore, banks are sensitive to rising global interest rates and a drying up of capital flows to Turkey.

In order to redress the current economic imbalances additional steps seem to be unavoidable. Therefore, it is expected that financial conditions will be tightened in the coming months. This, together with higher inflation and a weaker exchange rate will hamper domestic demand and probably lead to a sharp decrease in GDP growth in 2019. However, exports will be boosted by the weaker lira exchange rate. This, together with sharply decreasing import demand will lead to a much lower current account deficit in 2019. Any comprehensive monetary and fiscal tightening to rein in inflation, coupled with convincing signs that the Central Bank can act independently from political influence would improve investors' perception.

Real fixed investment (y-on-y, % change)



Sources: Macrobond, Oxford Economics

Structural constraints for higher long-term growth remain

Without comprehensive reform efforts beyond fixing short-term issues the future earnings capacity of the Turkish economy remains constrained by macroeconomic imbalances related to high credit growth, high inflation and a large external deficit, coupled with structural issues related to its low savings rate and weaknesses in competitiveness, limiting FDI inflow. The investment climate is also hampered by a weak judicial system and an inflexible labour market. Moves to privatise state banks and the power sector are also proceeding too slowly. Without structural reforms to raise savings, reduce dependency on energy imports and improve the investment climate, Turkey´s potential growth rate will decrease to 3% - 3.5% per annum - not enough to absorb the increase in the working age population of about one million people per year.

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