

# Central and southeast Europe - summary

## Regional economies

The region suffered badly from the crisis, with GDP contracting sharply in 2009, falling by as much as 7.1% in Romania. In the EU, only Poland enjoyed a small increase in output. Recovery now proceeds at different speeds, impeded by local problems.

First quarter 2010 showed some improvement but overall it lacks solid foundations. GDP growth was driven mostly by pre-election government spending (Hungary, Slovakia) or by exports to western Europe, where recovery has now stalled. In all countries, local demand will remain sluggish until the end of the year. Two of the countries are still in recession (Bulgaria, Romania) and one is out of it only in theory (Hungary). Slovakia and Czech Republic are highly geared towards Germany, so their recoveries are highly vulnerable to German internal policies. Only Poland has sustainable economic growth, driven by its vast local market.

Fiscal discipline is the biggest threat to

recovery in the region. No country risks a Greek-style crisis but politicians are showing little real dedication to cutting spending. Hungary and Romania have IMF loans but debt covenants do not help much.

Unemployment is likely to stay high this year. A recent decline in joblessness is fuelled largely by seasonal jobs.

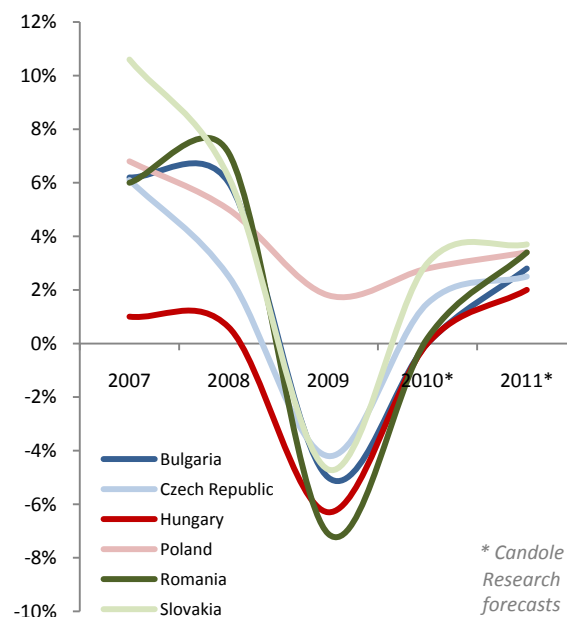
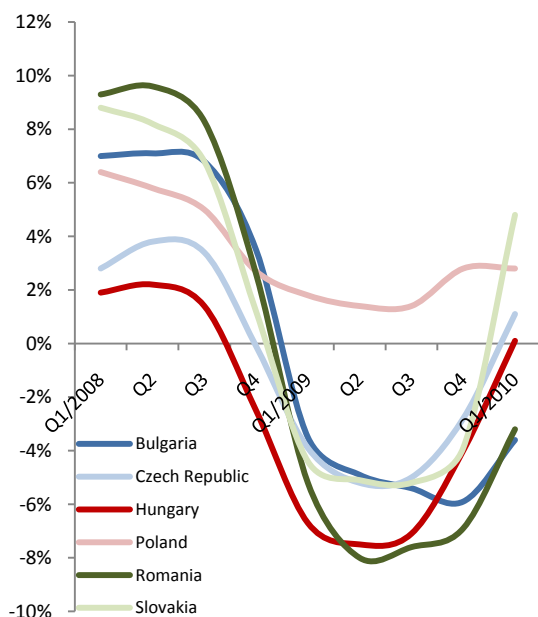
High inflation is a problem in Romania and Hungary, which risk stagflation.

Exchange rates are an issue. In some cases, local currencies have become uncompetitive. In others, the population suffers from painful exposure to foreign-denominated mortgages.

Overall, households lost purchasing power last year. Real wage growth is either minimal or non-existent. Spending patterns have shifted permanently, and savings rates have skyrocketed.

Real recovery is expected only in 2011.

### GDP performance by quarters and years, with annual forecasts



\* Candore Research forecasts

## Regional retail sales

In 2009, retail sales collapsed in five out of the six reviewed countries. The magnitude of the decline depended on when the crisis hit in each country (see previous page).

In Hungary, where the economic crisis happened earliest, nominal turnover declined only marginally (-3.7%) last year. But the real decline was sharper after accounting for 4.2% price inflation. In 2010, CPI growth will continue to erode retail sales growth.

In Bulgaria, where the bottom of the crisis came as late as Q4/2009, the contraction continues to be very strong. For 2010, we expect a -6% drop, the sharpest of all countries. Unemployment remains high and consumers are overly pessimistic.

In the Czech Republic, retail sales fell by 6% in 2009, after years of consecutive growth. The

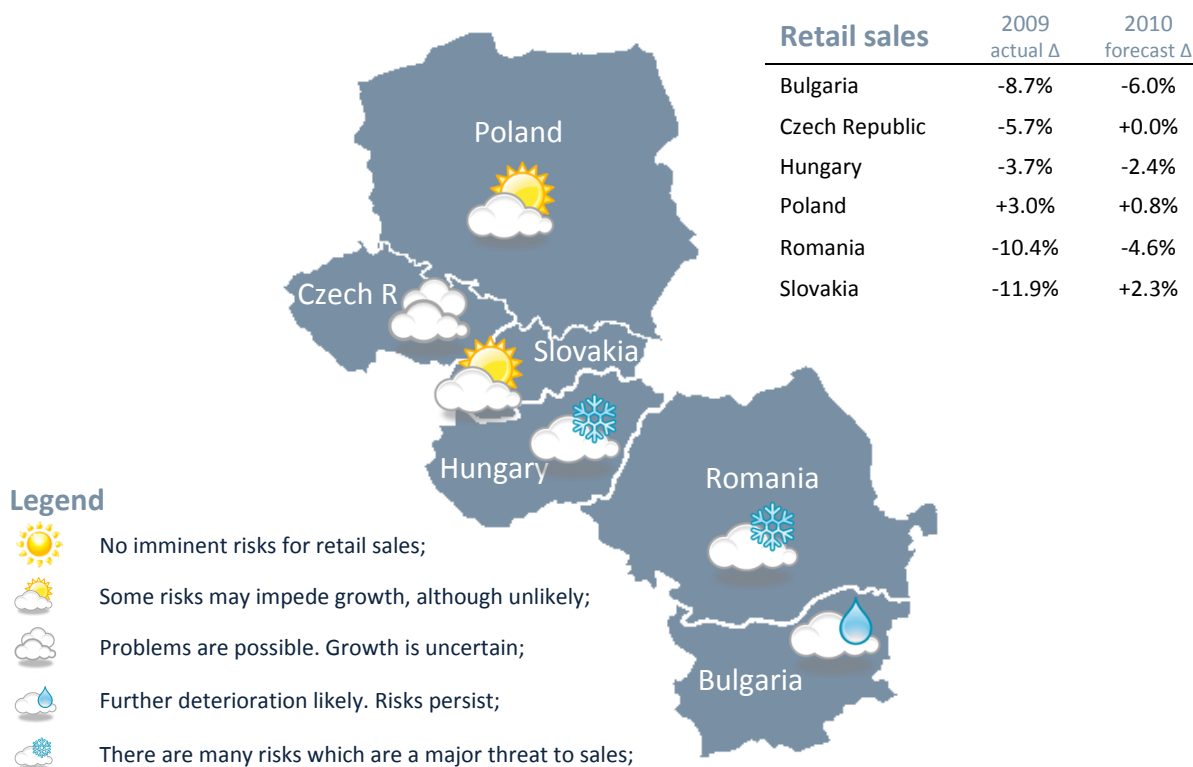
stronger local market made sales less volatile than in the other countries. Although we expect 0% growth this year, the population is regaining its purchasing power.

Poland was the only country where retail sales grew in 2009. But as the unemployment peaked only in Q1/2010, the growth this year is likely to be smaller – less than 1%.

Romanian retail sales were in a difficult position in 2009. After falling by 10% in 2009, we see further 4.6% decline in 2010. The government's austerity measures are a major contribution to the poor sector performance.

Slovak retail sales fell by 12% last year. But as the economy is rising quickly, retail sales are likely to grow by 2%. Although unemployment rate remains very high, local demand is slowly regaining strength.

### Retail sales in 2010 – forecasts and risks surrounding them



# Romania



## Summary

The Romanian economy is likely to contract again this year, after a 7.1% decline in 2009. In the first quarter, GDP fell by 2.3% y/y, and most growth forecasts have now been revised downwards.

The IMF, which runs a stand-by agreement with Romania, puts strong pressure on the government to curb the growing budget deficit. The Romanian president proposed a series of austerity measures (including lower funding for municipalities, 25% cut in public wages and 15% cut in pensions), all of which face strong opposition. If implemented in June as planned, these measures increase the risk of the domestic economy contracting. The cuts threaten private consumption and would put downward pressure on government spending.

Unemployment in Romania is lower than in other countries in the region. There has been a recent drop in unemployment, but we believe it is temporary, and a rise is very likely in the autumn. The bloated public sector, which increased by 250,000 between 2006 and 2008, will most likely revert to pre-2006 levels.

Romania has deep fiscal problems. The consolidated budget deficit in 2009 was 8.3%, resulting mainly from weak revenue collection (32% of GDP, vs. 44% EU average). The finance

ministry is overly optimistic for the 2010 budget deficit (based on unrealistic GDP growth and VAT collections), so its austerity measures would appear to be inadequate at this stage. Instead of raising taxes, as the IMF recommends, the government has opted for drastic spending cuts. Nevertheless, we consider it probable that the government will have to raise VAT and income tax.

The proposed austerity measures pose major political risk, with negative impacts upon the local economy and therefore retail sales). If implemented, the purchasing power of the population will fall yet further, and the government may fall. If not implemented, Romania would breach its debt covenants with the IMF and sequential loan tranches (€2bn) may not be transferred. International investors are likely to be dissuaded by the dire state of public finances and lack of political will for reforms.

These factors pose a major threat to Romanian retail. We expect retail sales to fall further, after the 10.4% decline last year. Growth is likely to resume in 2011.

**Candole Research 2010 retail sales forecast: -4.6%.**