Baker Ing

Eastern Europe & Central Asia Economic Outlook

January 2021

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Contents

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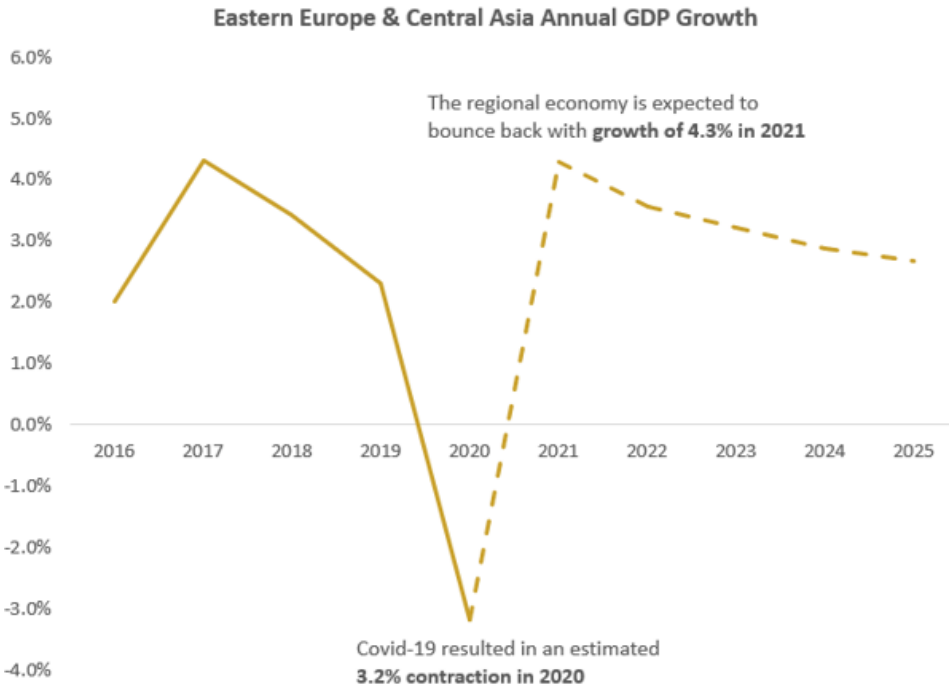
Regional Overview: Eastern Europe & Central Asia

Macroeconomic Developments & Outlook

Macroeconomic developments in 2020 were dominated by the outbreak and spread of the COVID-19 pandemic. Regional output collapsed in the first half of the year, as growing case rates and pandemic-related lockdowns caused domestic demand to plunge. Manufacturing and services activity were hit sharply by major supply chain disruptions along with the slump in activity both domestically and globally. GDP contracted by an estimated 3.2% on average across the region in 2020.



Source: IMF; Baker Ing
- 2020 data is estimated, and data for 2021 onwards is based on forecasts (indicated by the dashed lines).
- Annual GDP growth has been calculated as a weighted average for the Eastern Europe & Central Asia (EECA) region, which includes the following 29 countries: Albania; Armenia; Azerbaijan; Belarus; Bosnia & Herzegovina; Bulgaria; Croatia; Czech Republic; Estonia; Georgia; Hungary; Kazakhstan; Kyrgyz Republic; Latvia; Lithuania; Moldova; Montenegro; North Macedonia; Poland; Romania; Russia; Serbia; Slovakia; Slovenia; Tajikistan; Turkey; Turkmenistan; Ukraine; Uzbekistan.

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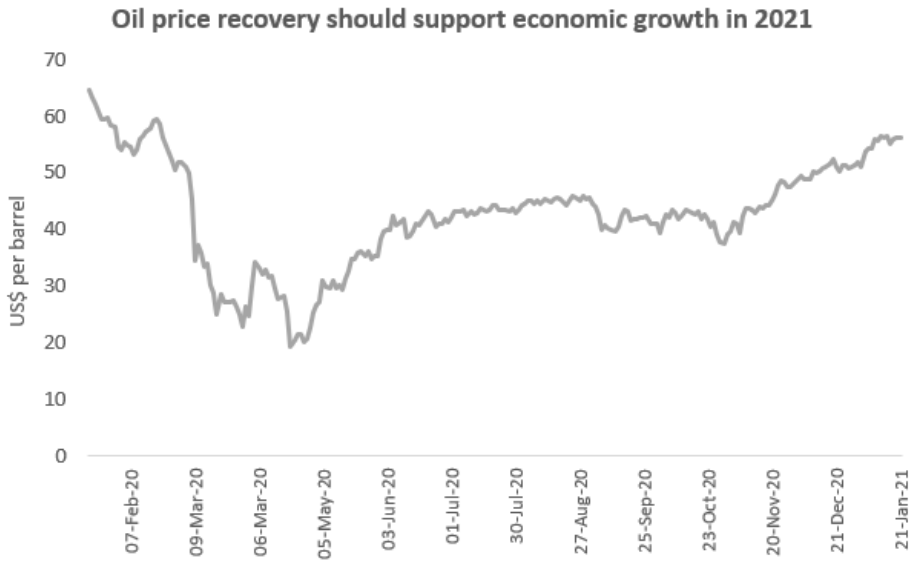
The hardest hit economies have generally been those with strong trade linkages to Russia and/or the Eurozone, as well as those that are heavily reliant on one or more of the following: remittances from workers based abroad (remittances have slumped amid job losses in host economies); revenue from tourism; and energy and metals exports. Indeed, the slump in oil prices in early 2020 – the price of a barrel of Brent crude fell below $20 per barrel in late April – landed a severe blow to the region's big oil exporters, including Russia, Kazakhstan and Azerbaijan.



Source: Nasdaq.com; Baker Ing

Growth is expected to recover in 2021, with regional GDP projected to rebound by around 4.3%. However, the downside risks to this outlook are high. The pace and extent of the recovery will depend crucially upon the duration of the pandemic (and associated restrictions), vaccine availability and rollout, commodity price developments, and a revival in global confidence.

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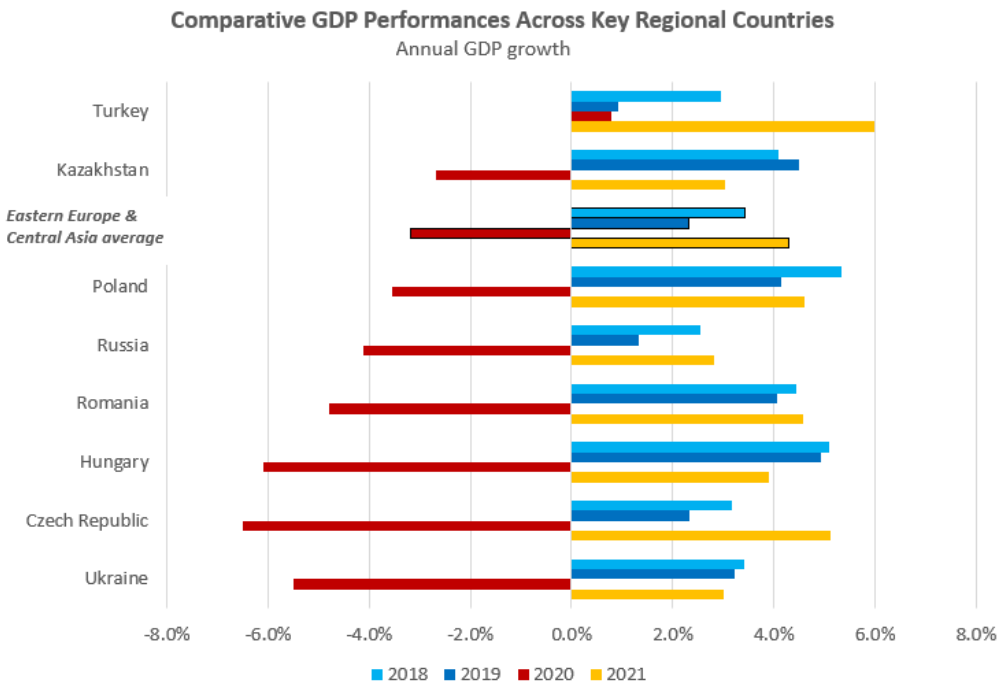
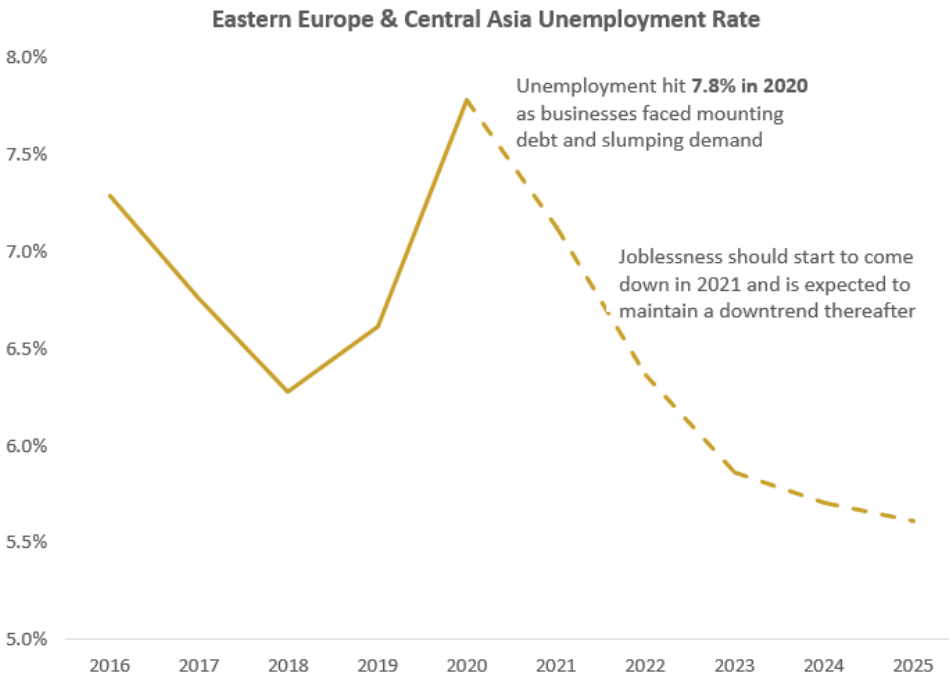


Source: IMF; Baker Ing
- Data for 2020 and 2021 is based on IMF estimates and forecasts.

After having registered below 7% in each of the preceding three years, regional unemployment is estimated to have hit almost 8% in 2020, as mass lockdowns and restrictions pushed the region into a deep recession and many businesses were forced to scale back or shut down amid plummeting demand and spiralling debt levels. While the unemployment rate should start to come down in 2021 as the regional recovery gets underway, it is unlikely to fall back below 7% until 2022 at the earliest.



Source: IMF; Baker Ing
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- Unemployment has been calculated as a weighted average for the Eastern Europe & Central Asia region.

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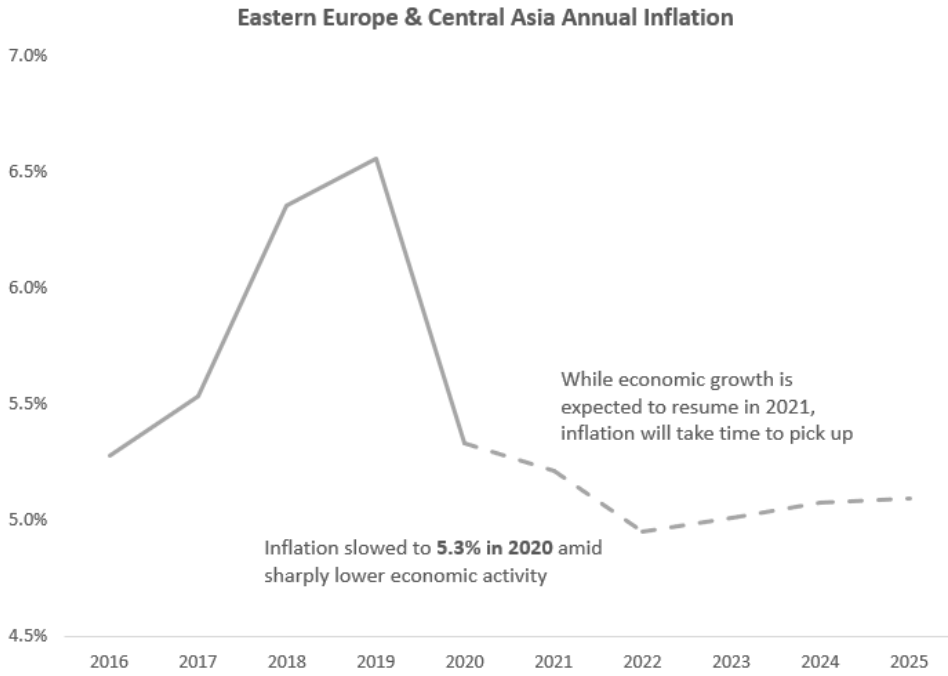
On the inflation front, the collapse in global oil prices and coronavirus-related lockdown measures caused inflation to fall from 6.6% y/y in 2019 to 5.3% in 2020 – the lowest rate of consumer price growth in the region since 2016.

Despite the expected pick-up in economic activity in 2021, inflationary pressures are likely to stay subdued as consumers remain cautious, real wage growth is still weak (and in some cases negative), and government support gradually fades.



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Sovereign Credit Ratings

The table below shows the sovereign credit ratings for all countries in the region, from the big three credit rating agencies globally. Companies that have large public sector ownership, as well as those that borrow heavily from banks, are subject to sovereign risk via both the fiscal and financial channels. When investors believe a country is more likely to default on its debt, the interest rates paid on the debt of that country increase, in order to compensate investors for the higher perceived risk. In such situations, it is often the case that banks see their funding costs increase as well. As such, when sovereign credit risks are elevated, companies in that country can also see their credit risk increase, for example via less favourable bank lending conditions.

	Moody's		S&P		Fitch	
	Rating	Outlook	Rating	Outlook	Rating	Outlook
Czech Republic	Aa3	Stable	AA-	Stable	AA-	Stable
Estonia	A1	Stable	AA-	Stable	AA-	Stable
Slovakia	A2	Stable	A+	Stable	A	Negative
Poland	A2	Stable	A-	Stable	A-	Stable
Lithuania	A3	Positive	A+	Stable	A	Stable
Slovenia	A3	Stable	AA-	Stable	A	Stable
Latvia	A3	Stable	A+	Stable	A-	Stable
Bulgaria	Baa1	Stable	BBB	Stable	BBB	Stable
Hungary	Baa3	Positive	BBB	Stable	BBB	Stable
Kazakhstan	Baa3	Positive	BBB-	Stable	BBB	Stable
Russia	Baa3	Stable	BBB-	Stable	BBB	Stable
Romania	Baa3	Negative	BBB-	Negative	BBB-	Negative
Croatia	Ba1	Stable	BBB-	Stable	BBB-	Stable
Azerbaijan	Ba2	Stable	BB+	Stable	BB+	Negative
Georgia	Ba2	Stable	BB	Stable	BB	Negative
Serbia	Ba3	Positive	BB+	Stable	BB+	Stable
Armenia	Ba3	Stable	-	-	B+	Stable
North Macedonia	-	-	BB-	Stable	BB+	Negative
Uzbekistan	B1	Stable	BB-	Negative	BB-	Stable
Albania	B1	Stable	B+	Stable	-	-
Montenegro	B1	Stable	B+	Negative	-	-
Turkey	B2	Negative	B+	Stable	BB-	Negative
Kyrgyz Republic	B2	Negative	-	-	-	-
Ukraine	B3	Stable	B	Stable	B	Stable
Bosnia and Herzegovina	B3	Stable	B	Stable	-	-
Belarus	B3	Stable	B	Negative	B	Negative
Moldova	B3	Stable	-	-	-	-
Tajikistan	B3	Negative	B-	Stable	-	-
Turkmenistan	-	-	-	-	-	-

Key

Investment Grade
Speculative Grade

Source: Moody's; S&P; Fitch; Baker Ing
- Ratings retrieved on 23rd Jan 2021
- Dashes (-) indicate that no data is available

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As can be seen from the table above, the majority of countries in the region (17 out of 29) currently have 'speculative grade' sovereign credit ratings. This suggests that the credit risks associated with doing business with entities in the region are generally substantial. Nevertheless, none of these countries currently have credit ratings below 'B,' which means that they are all within the higher rated half of the speculative category. Note that the lowest speculative grade ratings are 'C' (Moody's) and 'D' (S&P and Fitch).

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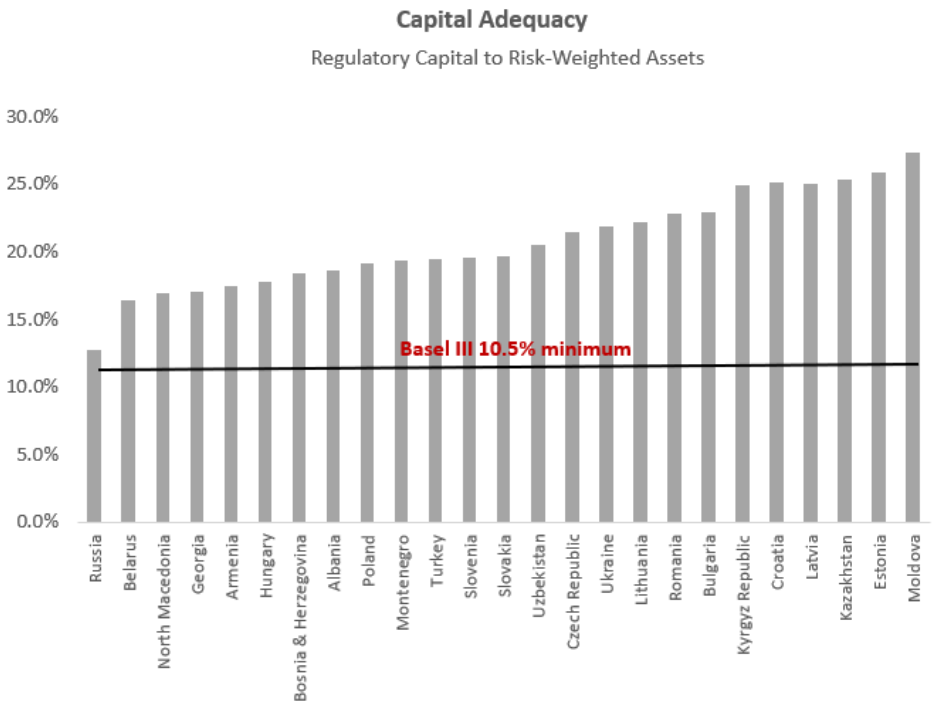
Banking Sector Update

The COVID-19 pandemic has had a negative impact on the banking sector across the globe. In an effort to facilitate the role of banks in absorbing the shock by supplying vital credit to households and the corporate sector, governments and central banks around the world have undertaken a number of measures to provide greater liquidity and support the flow of credit. Nevertheless, banking systems have come under significant stress. The biggest impact has been felt via banks' loan portfolios – given that many borrowers across different sectors are dealing with sharp declines in their income, they are facing difficulties in repaying their obligations as they come due.

An assessment of two key metrics from the IMF's Financial Soundness Indicators provides some insight into the health of the region's banking sector. The chart below shows the 'regulatory capital to risk-weighted assets' ratio (a measure of capital adequacy) for every country in the region for which data is available. This ratio gauges a bank's capital strength to withstand shocks and absorb unexpected losses. As per the Basel III global regulatory standard, banks are expected to have a capital adequacy ratio of at least 10.5%. As can be seen from the chart, all banks in the region currently exceed this minimum. Nevertheless, a deterioration in these positions going forward is highly likely given the ongoing impacts of the pandemic.



Source: IMF Financial Soundness Indicators; Baker Ing
- All EECA countries for which data is available are included in the chart
- Data is latest available (ranging from Q1 2020 – Q3 2020)

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A key metric that is used to assess asset quality is the ratio of banks 'non-performing loans to total gross loans.' High levels of non-performing loans (NPLs) are problematic because they impair bank balance sheets, depress credit growth, and delay economic recovery. As can be seen from the chart below, the NPL ratios of all other countries in the region are dwarfed by that of Ukraine, which stood at a massive 45.6% in Q3 2020. While the 2014-2016 financial and economic crisis in Ukraine was an important factor in driving the country's NPL ratio higher, more fundamental issues of banking sector dysfunction and bad practices linked to so-called 'oligarchic banking' were already causing problems long before then. Banking sector reform is ongoing. The authorities are taking measures to clean up, strengthen and improve oversight of the sector. Nevertheless, significant challenges remain and efforts to reduce the non-performing loan ratio are being stymied by the COVID-19 crisis.

Source: IMF Financial Soundness Indicators; Baker Ing
- All EECA countries for which data is available are included in the chart
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COVID-19 impact on Eastern Europe & Central Asia

Economic Impact

After being comparatively mildly affected in the first wave, Eastern Europe & Central Asia is now in the midst of a second wave of the COVID-19 pandemic, with far higher levels of infected people and fatalities compared to the first wave. The table below shows the number of deaths per 100,000 population in all countries across the region as of late January 2021. On this metric, Slovenia and the Czech Republic are the two nations that have been hit hardest so far. However, John Hopkins University's classification of the twenty countries currently most affected by COVID-19 worldwide actually includes five countries from the region (highlighted in red in the table below) – Russia, Poland, Ukraine, Turkey, and the Czech Republic. As well as taking account of deaths per 100,000 population, this classification also accounts for other information, such as the observed case-fatality ratio.

	Deaths/100K population
Slovenia	157.5
Czech Republic	139.5
Bosnia & Herzegovina	136.0
North Macedonia	131.5
Bulgaria	123.2
Montenegro	121.8
Hungary	118.9
Croatia	115.2
Armenia	102.2
Moldova	93.0
Lithuania	90.1
Poland	89.9
Romania	89.8
Georgia	80.1
Slovakia	68.6
Serbia	54.6
Latvia	53.6
Ukraine	49.9
Russia	45.8
Albania	45.0
Azerbaijan	30.6
Turkey	29.8
Estonia	26.4
Belarus	17.0
Kazakhstan	16.1
Uzbekistan	1.9
Tajikistan	1.0
Kyrgyz Republic	-
Turkmenistan	-

Source: John Hopkins University; Baker Ing
- The highlighted countries are those classified within the group of twenty countries currently most affected by COVID-19 worldwide.
- Note that under-reporting in some countries, particularly those in Central Asia, mean that the official figures likely significantly understate the true picture.

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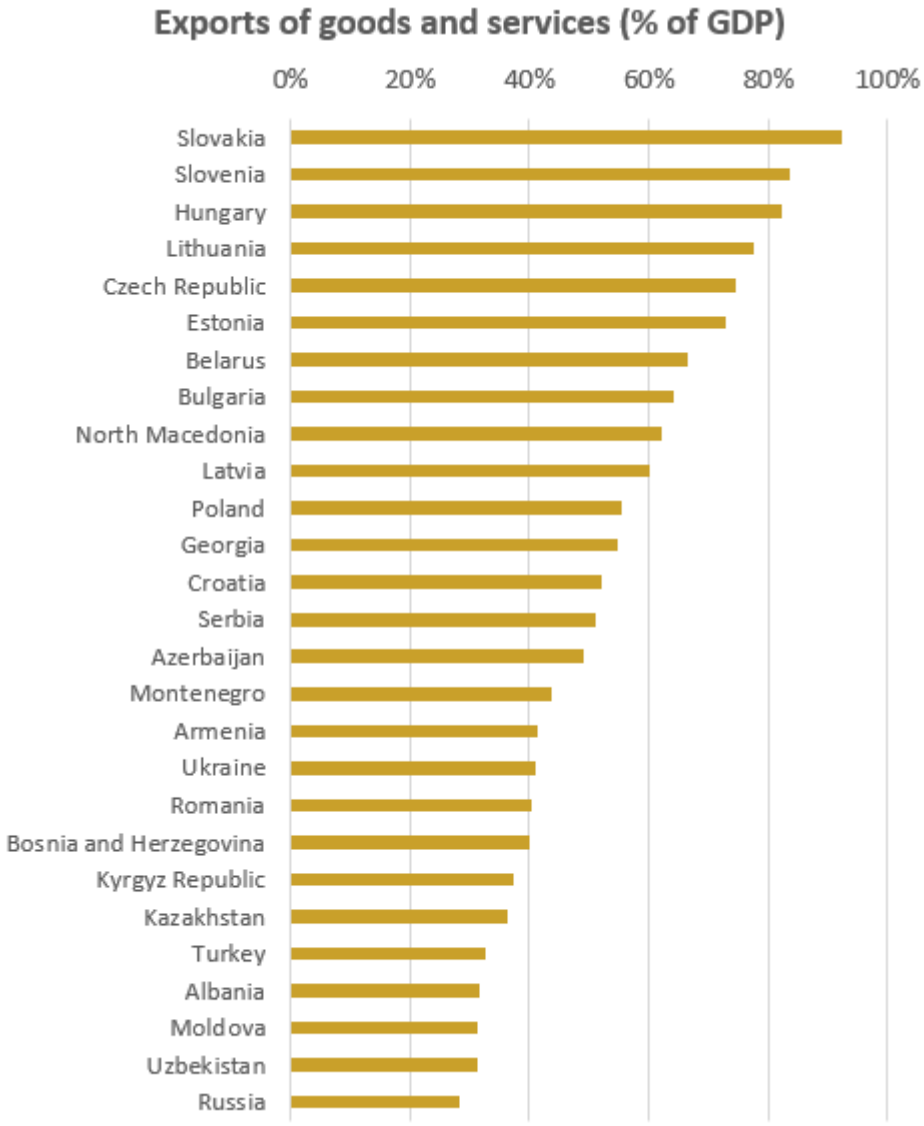
The second wave of the pandemic has led to the imposition of renewed restrictions and has serious implications for economic performance this year, particularly given the region's vulnerabilities. Indeed, Eastern European and Central Asian nations share three characteristics that make them particularly vulnerable to the economic fallout of the virus.

Firstly, many of their economies are export-dependent, leaving them highly exposed to the slump in global demand. Exports of goods and services as a share of GDP are particularly high in Slovakia (92%), Slovenia (84%) and Hungary (82%). In the rest of the region, external demand is also crucial; on average, across Eastern Europe and Central Asia, exports account for 53% of GDP.



Source: World Bank; Baker Ing
- Data is latest available (2019)

A second vulnerability stems from the fact that many governments in the region have limited capacity to finance support packages. While the majority

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have relatively low levels of public debt, weak credit ratings mean that investors are generally wary of lending to them.

Thirdly, many countries across the region are heavily dependent on tourism – one of the sectors hardest hit by the global pandemic. According to data from the World Travel & Tourism Council, the contribution of travel and tourism to GDP is as high as 26% in Georgia, 25% in Croatia and 21% in Albania. It is also a vital sector in Turkey, Bulgaria and Armenia, where it accounts on average for around 11% of GDP.

So while the pandemic has resulted in serious short-term economic consequences for the region, and will keep credit risks elevated in 2021, the crisis could bring about some opportunities in the medium-term. Indeed, given that many manufacturers are likely to reassess their future operations, given the massive global supply chain disruptions they have faced amid the pandemic, Eastern Europe and Central Asia could benefit from nearshoring, whereby processes and production are brought closer to home.

Vaccine rollout outlook

Vaccine rollout is likely to be slow in Eastern Europe & Central Asia. Indeed, vaccines are unlikely to be widely available until late 2021 at the earliest, given the challenges associated with securing sufficient supplies, as well as the logistical difficulties of organising and delivering mass vaccination programmes. On top of this, vaccine scepticism remains a challenge, particularly in the ex-Soviet countries of the region where attitudes towards vaccination have been shaped, at least to some extent, by negative healthcare experiences during the communist period. While Eastern European countries that are EU member states will see faster vaccine rollout than the rest of the region, current projected timescales are likely to be delayed, given that many EU countries have already been receiving lower-than-expected supplies.

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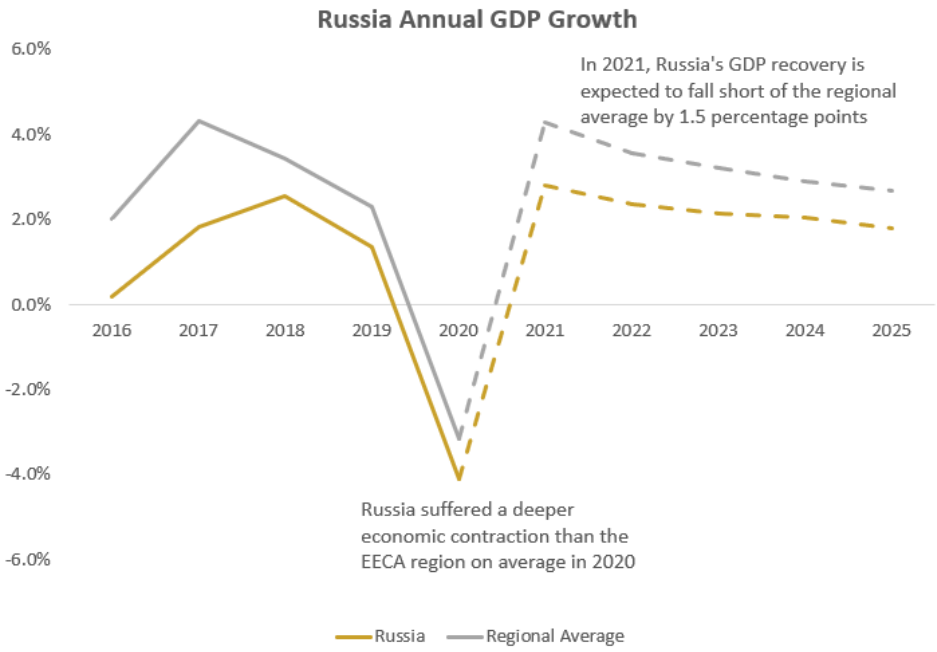
Russia

Economic Growth

The Russian economy contracted by an estimated 4.1% in 2020 – its steepest contraction in over a decade – on the back of immense pandemic-induced supply-and-demand shocks. Consumer demand, investment activity, and exports all plunged as authorities domestically and abroad were forced to implement strict lockdown and restriction measures.



Source: IMF; Baker Ing
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The economy should begin to recover this year, as the pandemic is expected to subside, particularly given planned mass global vaccine rollouts. Moreover, fiscal and monetary stimulus will further support the recovery. Activity in China, meanwhile, which is Russia's second-largest trading partner, is showing signs of picking up, with GDP having expanded by 6.5% y/y in Q4, This bodes well for Chinese demand for Russian exports in 2021. In addition, after having collapsed early last year as lockdowns and travel bans slashed the demand for oil, crude prices have been recovering and are expected to rise further this year.

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All in all, the IMF expects Russian GDP growth of 2.8% in 2021, which would be its strongest annual rate of growth since 2012.

However, there are many downside risks to this forecast which imply the projected economic recovery could be much softer.

Firstly, although energy prices are trending higher, they remain well below their pre-pandemic levels. Also, while the Organisation of the Petroleum Exporting Countries (OPEC) and its allies, including Russia, are limiting oil supply in an effort to support prices, global oil demand is still weak amid reduced travel and other pandemic-related restrictions. Energy exports are very important for Russia, accounting for over 60% of total exports by value in 2019.

Secondly, COVID-19 cases have risen sharply recently in the Eurozone – Russia's largest trading partner – meaning that export demand is still likely to remain relatively muted, at least in the early part of 2021.

Finally, while Russia has started to administer its Sputnik V COVID-19 vaccine domestically, the speed of rollout is likely to be relatively slow given significant infrastructural constraints and the under-resourced healthcare system.

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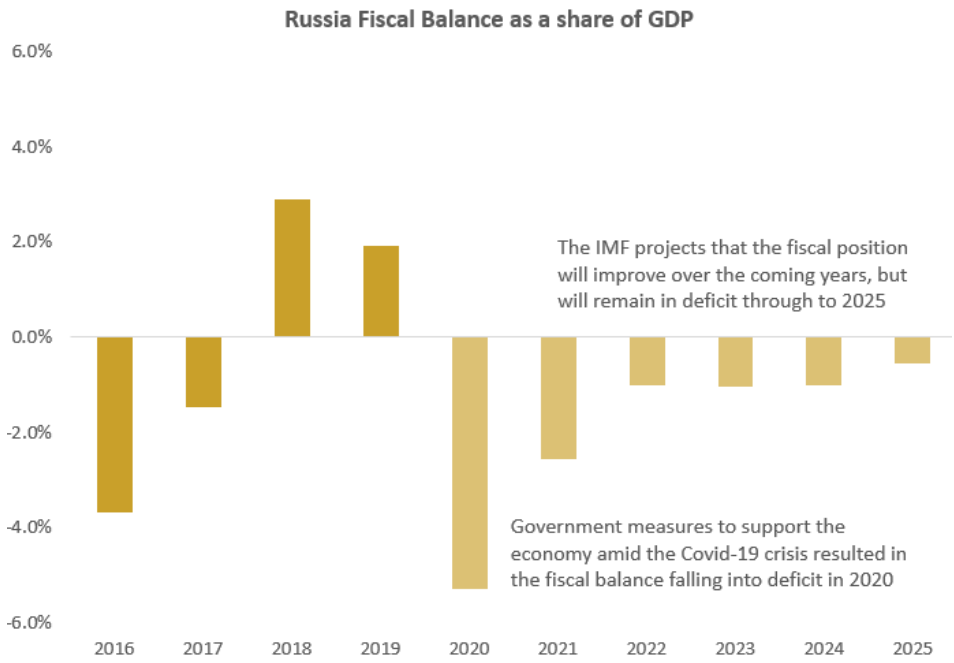
Fiscal Developments

The National Plan for Economic Recovery, adopted in June 2020, is the government's programme to help the economy recover from the COVID-19 crisis. It is due to run for 18 months and consists of a variety of support measures with a total cost of RUB6.4 trillion (US$83 billion). Combined with measures that were taken to address the immediate impact of COVID-19, this comes to a total of RUB7.2 trillion (US$93 billion) of support. These stimulus measures pushed Russia's fiscal balance into negative territory in 2020 for the first time in three years. Indeed, the fiscal deficit is estimated to have amounted to 5.3% of GDP last year.



Source: IMF; Baker Ing
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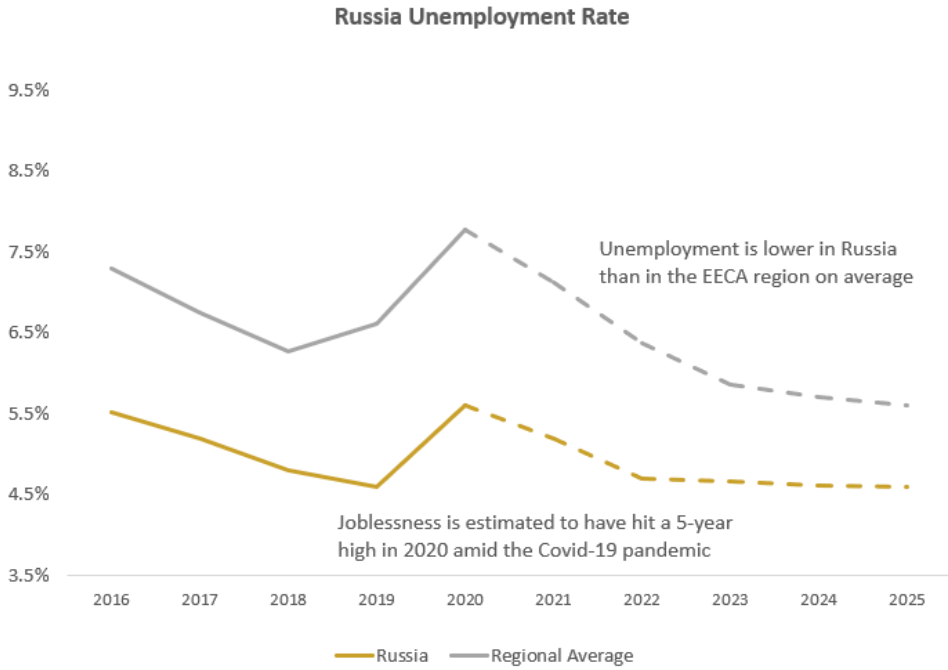
Unemployment

Unemployment in Russia spiked in 2020 amid the COVID-19 related business closures and scalebacks. The jobless rate stood at 6.1% in November, and according to IMF estimates, it will have registered a 5-year high in 2020 overall. The majority of job losses occurred in manufacturing, construction, and retail & hospitality services, with these losses explained by the lockdown measures and the difficulties of remote working in these sectors. Looking ahead, the unemployment rate is expected to gradually decline in the coming years but is unlikely to hit pre-pandemic levels until around 2024.



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Inflation

Consumer price growth soared to its highest rate in a year-and-a-half in December, hitting 4.9% y/y – almost a full percentage point above the Central Bank of Russia's 4.0% target. Accelerating price growth (coupled with rising unemployment) has negatively affected household purchasing power. Inflation has been driven higher by a global spike in food prices, as well as a sharp depreciation in the rouble – which has made imports costlier. Nevertheless, the plunge in domestic consumer and business demand amid the COVID-19 crisis has put a firm ceiling on demand-side inflationary pressures, which means that for 2020 as a whole, inflation likely subsided by around a percentage point from 2019.

Inflation is projected to trend sideways in 2021 as conflicting forces should generally balance each other out. On the one hand, there should be some uptick in demand side inflationary pressures as economic activity recovers. The rouble, however, should see some appreciation, which will help to reduce import costs.

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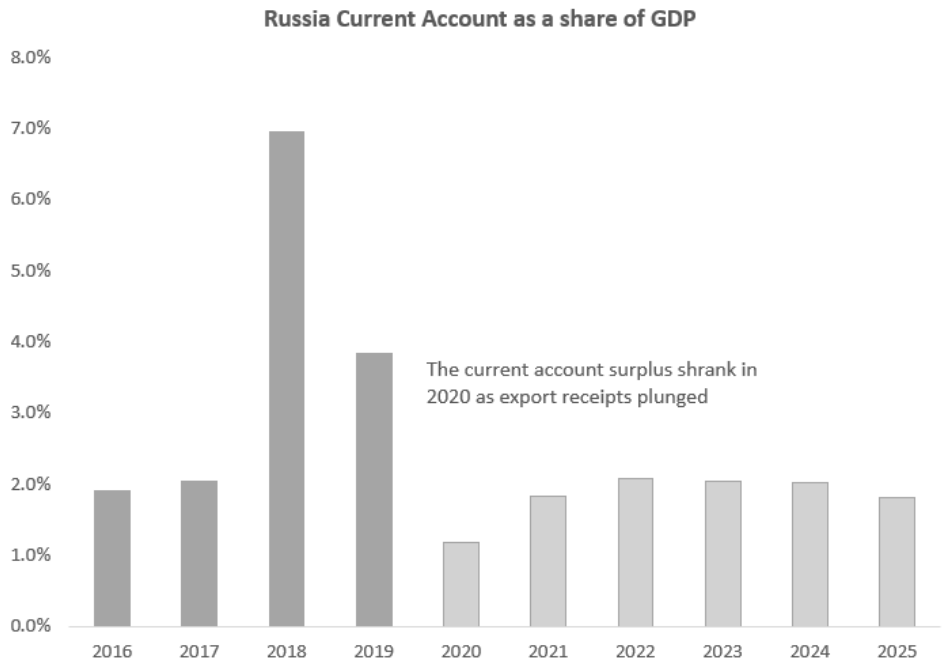
Currency Risk

The Russian rouble depreciated sharply in 2020, losing 15% of its value against the US dollar, as a number of factors weighed on the currency. Given Russia's strong reliance on energy exports, the hit to global energy demand amid the COVID-19 pandemic led to a huge drop in oil export receipts and was a major driver of the currency's downtrend. The big drop in exports is reflected in the contraction of the current account surplus – which fell to an estimated 1.2% of GDP in 2020 – its lowest since 1998.



Source: IMF; Baker Ing
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Other factors that caused capital outflows in 2020 and thus contributed to the rouble's weakness, were a decline in investor appetite for riskier assets and increased geopolitical risks. Regarding the latter, there are concerns over the possibility of new US economic sanctions against Moscow, given that a new US administration – which will likely take a more hawkish stance towards Russia – is now in power.

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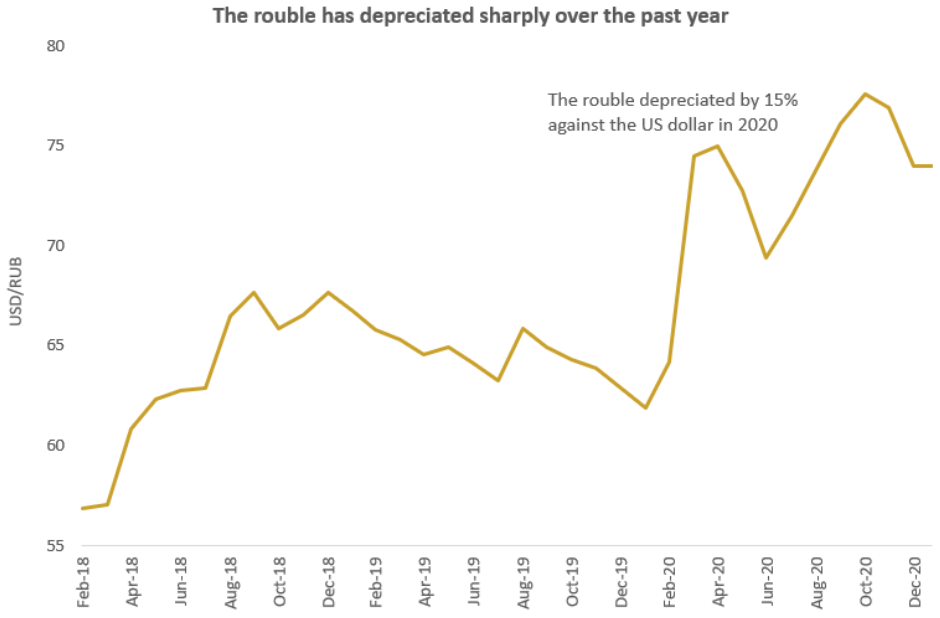
Rouble depreciation has increased balance sheet vulnerabilities for firms with significant levels of foreign currency-denominated debt, thus increasing credit risks.

Nevertheless, Russia's healthy level of foreign exchange reserves means that the authorities have substantial buffers in place to support the currency. Indeed, the selling of foreign currency reserves in 2020 helped to cushion the rouble's decline, and the government is likely to intervene further in 2021 when necessary.



Source: OFX.com; Baker Ing

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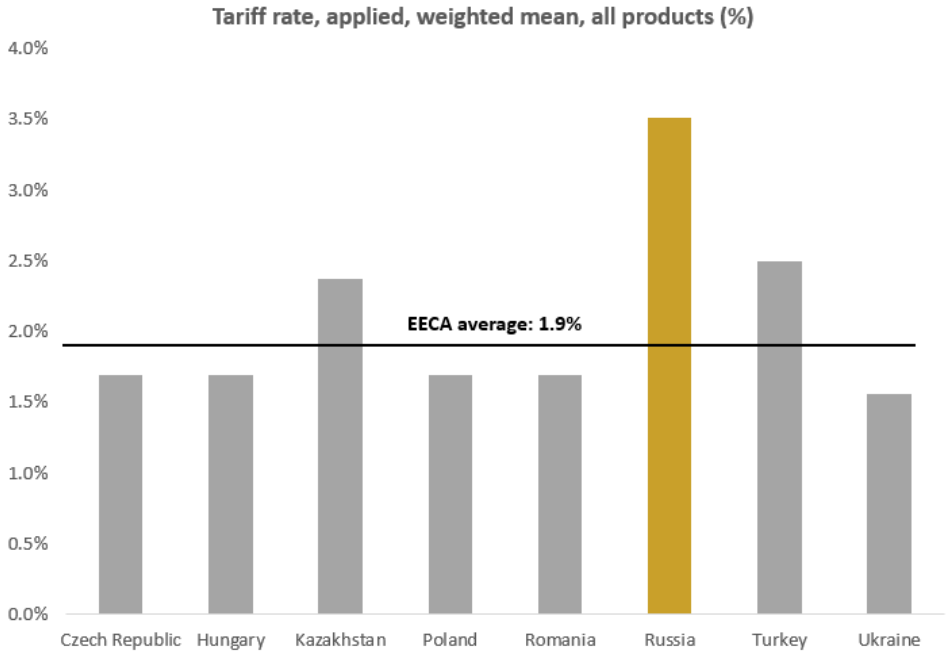
Trade Barriers

Russia's tariff barriers are relatively high compared with other countries in Eastern Europe & Central Asia. The applied weighted mean tariff rate was 3.5% in 2018 (latest data available), substantially above the regional average of 1.9%.

A Russian embargo on most Western food imports was introduced in 2014, in response to sanctions imposed by the US and EU on Russia after its invasion of Ukraine. The embargo was recently extended until the end of 2021.



Source: World Bank; Baker Ing
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- Data is latest available (2018)
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Non-tariff barriers to cross-border trade are extensive in Russia. In the World Bank's *Doing Business 2020* report, Russia is ranked at an unimpressive 99th out of 190 economies globally for the category 'trading across borders.' According to the report, the time and costs associated with both exporting and importing in Russia are, on balance, substantially higher than in the Europe & Central Asia region on average.

		Russia	Europe & Central Asia
Time to export	Border compliance (hours)	66	16.1
	Documentary compliance (hours)	26	25.1
Cost to export	Border compliance (USD)	580	150
	Documentary compliance (USD)	80	87.6
Time to import	Border compliance (hours)	12	20.4
	Documentary compliance (hours)	43	23.4
Cost to import	Border compliance (USD)	400	158.8
	Documentary compliance (USD)	160	85.9

Source: World Bank; Baker Ing
- The World Bank's Europe & Central Asia region includes 58 countries.

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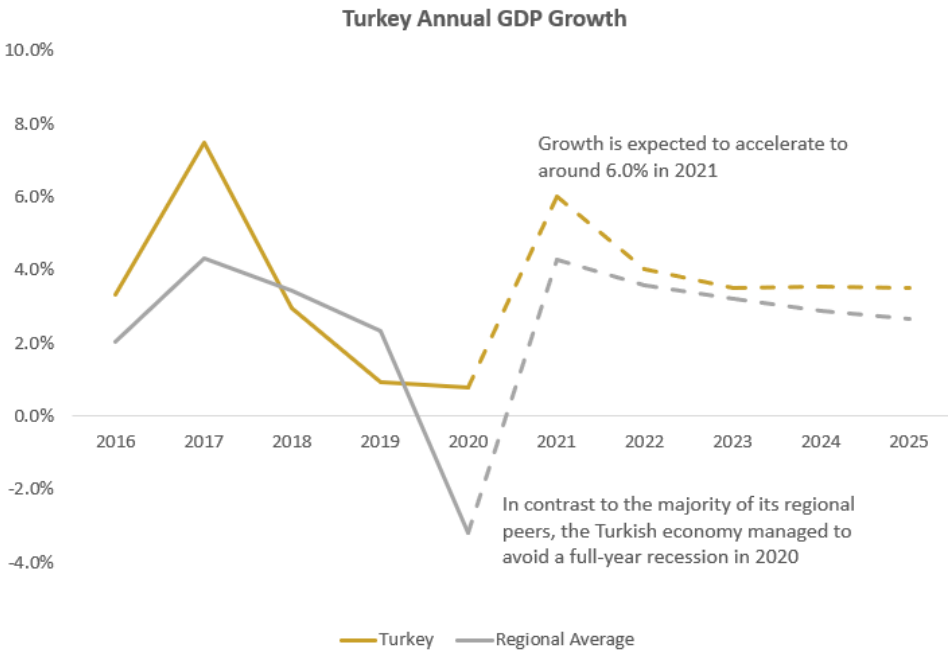
Turkey

Economic Growth

The Turkish economy looks to have narrowly avoided a contraction in 2020, in contrast to the vast majority of its regional peers. GDP growth is estimated to have registered at around 0.8%, as largescale credit and monetary stimulus in the first half of the year helped to mask the fallout from the coronavirus.



Source: IMF; Baker Ing
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While the government-led credit push and rate cuts from the politicised central bank helped Turkey avoid a full-year recession in 2020, they have led to an intensification of macroeconomic imbalances – the lira depreciated sharply last year, the current account deficit has widened, foreign exchange reserves have been depleted, and inflation remains stubbornly high.

Indeed, the unsustainability of such ultra-loose credit and monetary policies prompted the authorities to reverse course in late 2020. In response to the lira hitting record lows, credit stimulus was reined in and the central bank has hiked the key policy interest rate by a cumulative 875 basis points since end-September.

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While the adoption of a more conventional policy approach should help to rein in macroeconomic imbalances going forward, access to credit in this environment will become more challenging for firms and households, thus increasing payment risks. This is especially the case given that Turkish corporates are highly indebted in foreign currency, exposing them to the lira's weakness.

GDP growth looks on course to pick up significant steam in 2021, with the IMF projecting a full-year expansion of around 6.0%, helped by the roll-out of a vaccine, an improving economic picture across key trading partners, and large positive growth carryover from 2020. Nevertheless, the economic realities faced by firms and households will remain challenging, with inflation in double-digit territory, high unemployment and tighter credit access. Moreover, downside risks to the growth forecast are elevated, particularly given the high level of uncertainty over the evolution of the COVID-19 pandemic and the challenges associated with mass vaccine distribution.

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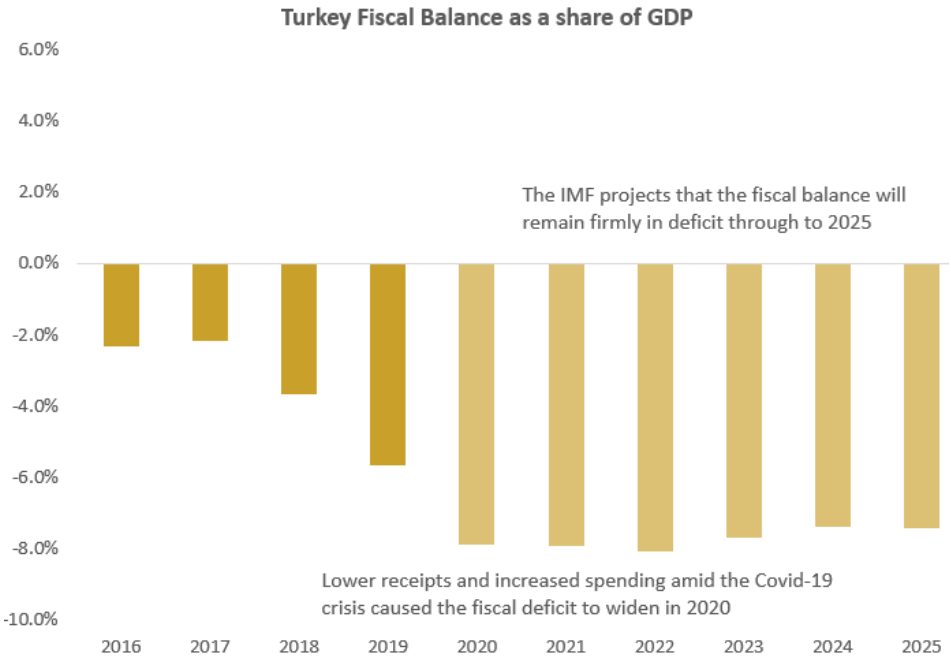
Fiscal Developments

In terms of the fiscal picture, a decline in revenue, and a concurrent (albeit relatively limited) increase in government spending to help mitigate the impacts of the COVID-19 crisis, caused Turkey's already-weak fiscal position to deteriorate further in 2020. Turkey will likely continue to record sizeable budget deficits through to 2025.



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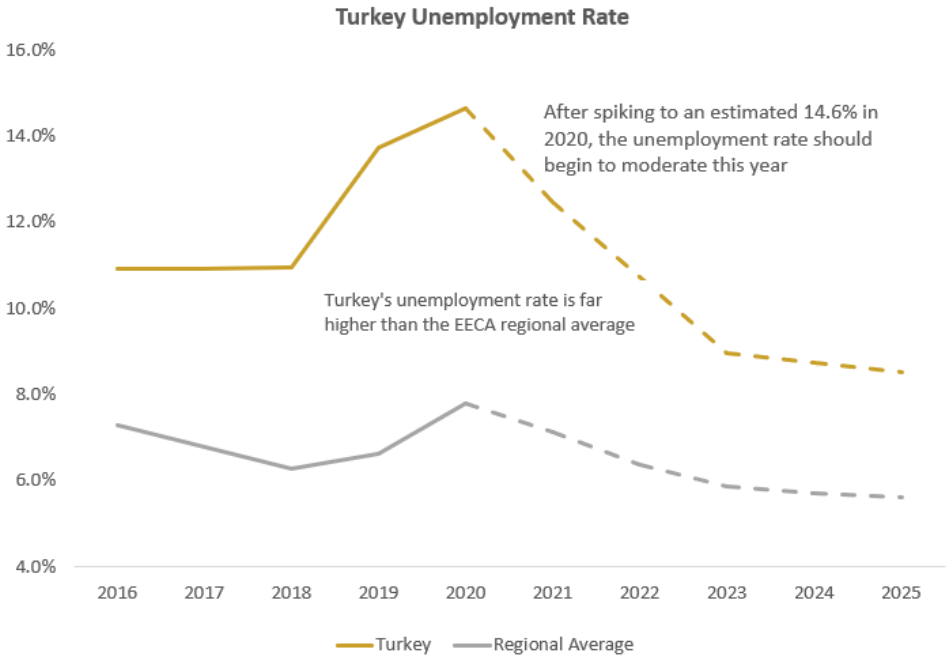
Unemployment

Turkey's employment crisis has been compounded by the economic effects of COVID-19. The official unemployment rate stood at an elevated 12.7% in October (latest data available), but even this is believed to underrepresent the true picture. Indeed, the headline figure masks a rise in the number of people falling out of the labour force, many having become disillusioned with not finding work. Turkey's rigid labour market regulations are a major cause of chronically high unemployment. Joblessness among young people is a particular problem – the latest figures show the youth unemployment rate stands at 24.9%. Moreover, a ban on firing employees during the pandemic means that the full impact of the COVID-19 crisis on future employment levels is not provided by the current data. Looking ahead, the unemployment rate is expected to gradually decline in the coming years but will remain firmly above the regional average.



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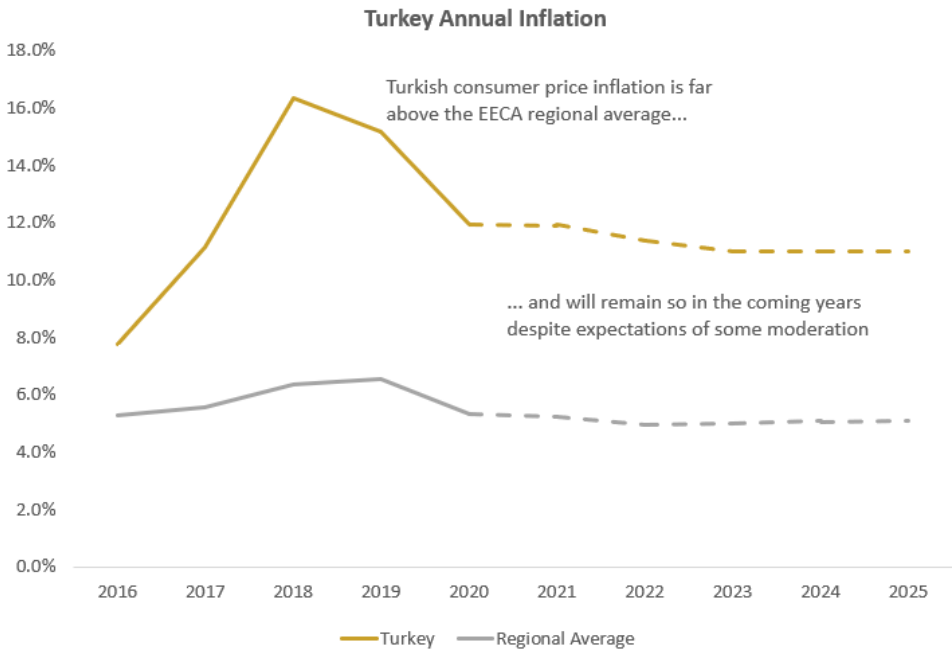
Inflation

After averaging at around 8% for over a decade, consumer price inflation in Turkey has been higher and more volatile since 2017, as sharp depreciations in the lira have inflated import costs and stoked inflation expectations. The inflation rate soared to 14.6% y/y in December, its highest rate since August 2019. Currency weakness, pandemic-related supply problems, and a surge in credit-driven demand (amid the loose policy backdrop in the first three quarters of the year) have all been contributing factors.

The recent tightening of monetary policy, and the possibility of further interest rate hikes in the first half of the year, should see inflation moderate going forward, but it will remain well above the central bank's 5.0% target.



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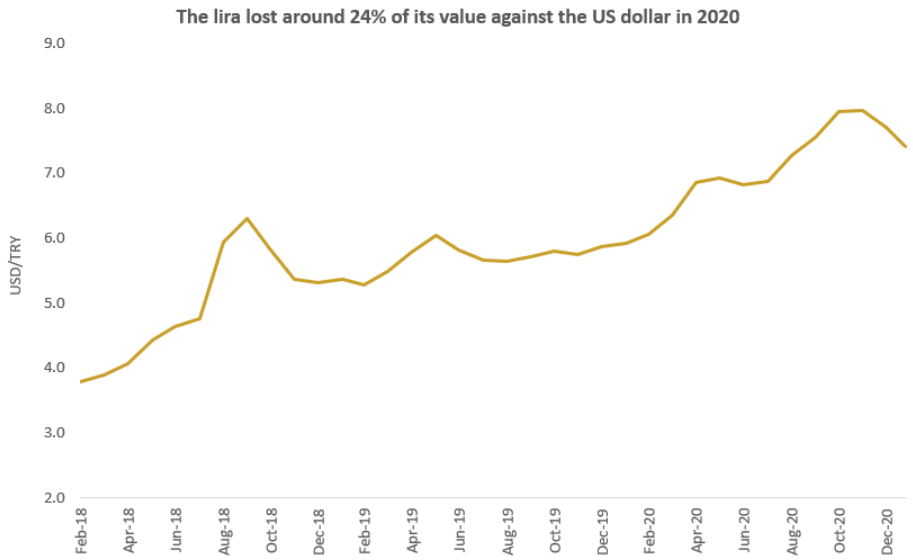
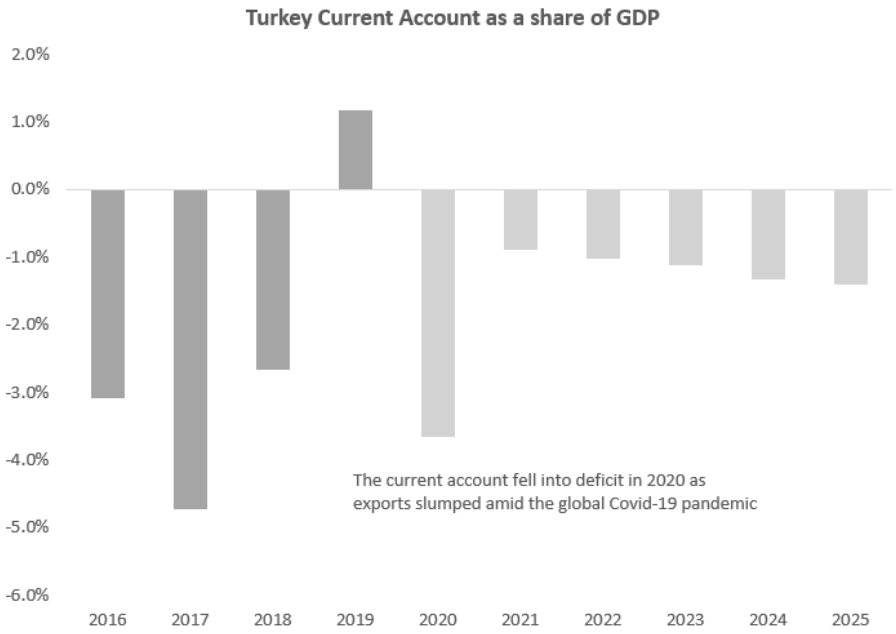
Currency Risk

The Turkish lira depreciated sharply in 2020, hitting a record low of almost TRY8.6:USD in November. The ultra-loose monetary policy stance, enacted by the central bank in the early stages of the COVID-19 crisis, contributed to a lira sell-off.



Source: OFX.com; Baker Ing

While the more hawkish stance adopted by the monetary authorities in the latter part of last year has helped to stabilise the currency, it remains subject to depreciation pressure going forward. The country's already-low foreign currency stockpiles were eroded last year as the authorities tried to defend the currency. Moreover, cautious investor sentiment and the current account deficit are also sources of downward pressure on the lira.



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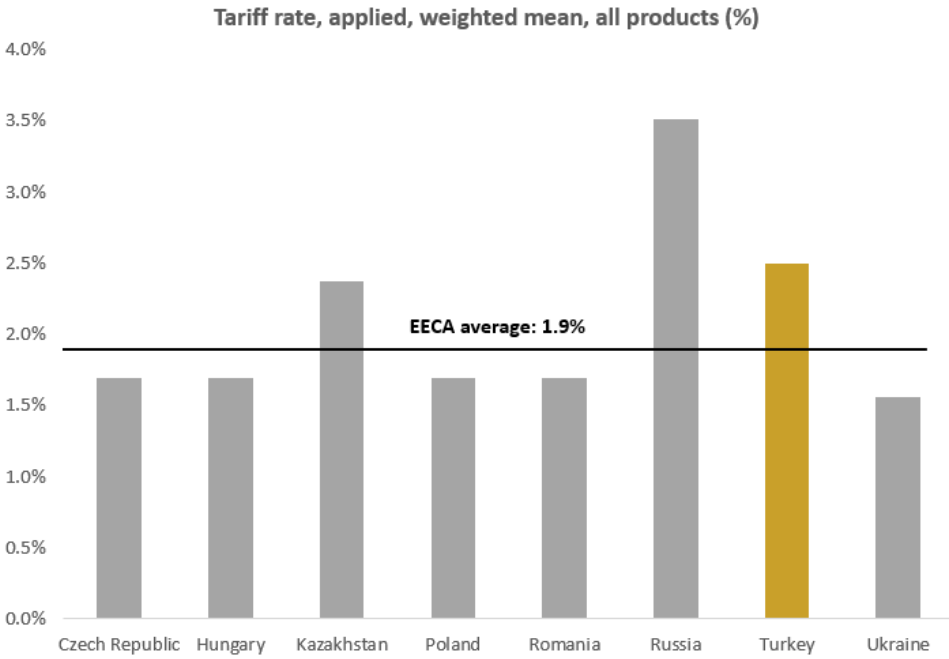
Trade Barriers

While less than Russia's, Turkey's tariff barriers are nonetheless relatively high compared with the average encountered in Eastern Europe & Central Asia. The applied weighted mean tariff rate was 2.5% in 2018, 0.6 percentage points above the regional average of 1.9%.



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While Turkey has made good progress in reducing non-tariff barriers to cross-border trade in recent years, more progress is needed – for example in addressing sometimes burdensome compliance requirements, and reducing potentially unnecessary and intrusive inspections. Nevertheless, in the World Bank's *Doing Business 2020* report, Turkey is ranked at a respectable 44th out of 190 economies globally for the category 'trading across borders.' According to the report, the time and costs associated with both exporting and importing in Turkey are generally significantly lower than in the Europe & Central Asia region on average.

		Turkey	Europe & Central Asia
Time to export	Border compliance (hours)	10	16.1
	Documentary compliance (hours)	4	25.1
Cost to export	Border compliance (USD)	338	150
	Documentary compliance (USD)	55	87.6
Time to import	Border compliance (hours)	7	20.4
	Documentary compliance (hours)	2	23.4
Cost to import	Border compliance (USD)	46	158.8
	Documentary compliance (USD)	55	85.9

Source: World Bank; Baker Ing
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Poland

Economic Growth

Poland's economy has started to bounce back from the COVID-19-triggered recession, but a spike in cases during the end of 2020 will delay the recovery. GDP is estimated to have declined by 3.6% in 2020 – marking the first full-year recession in Poland since 1991 – as the pandemic led to a plunge in activity, particularly in the first half of the year. Nevertheless, the extent of Poland's downturn was milder than in a number of other key regional countries, including Russia, Romania, Hungary, the Czech Republic and Ukraine, which are all estimated to have seen sharper economic contractions in 2020. This, in part, reflects the well-diversified nature of the Polish economy. It is one of the least reliant on the tourism sector among its regional peers and also has substantial agri-food and business services sectors – both of which have been relatively resilient to the crisis.

Growth should rebound to around 4.6% in 2021, supported by healthier external and domestic demand, as global confidence gradually recovers amid vaccine rollouts and the easing of restriction measures, and as supply chains begin to be restored. Continued fiscal and monetary accommodation will also bolster economic activity. In addition, the build-up of savings accumulated during lockdown periods will help the retail sector to recover this year. However, this will take time to materialise, particularly given that a fresh lockdown was imposed on December 28th and is to continue through to at least January 31st. This will weigh heavily on household consumption, as non-essential stores have been forced to close during this period. Moreover, rising unemployment will be a limiting factor to the extent of any retail recovery.

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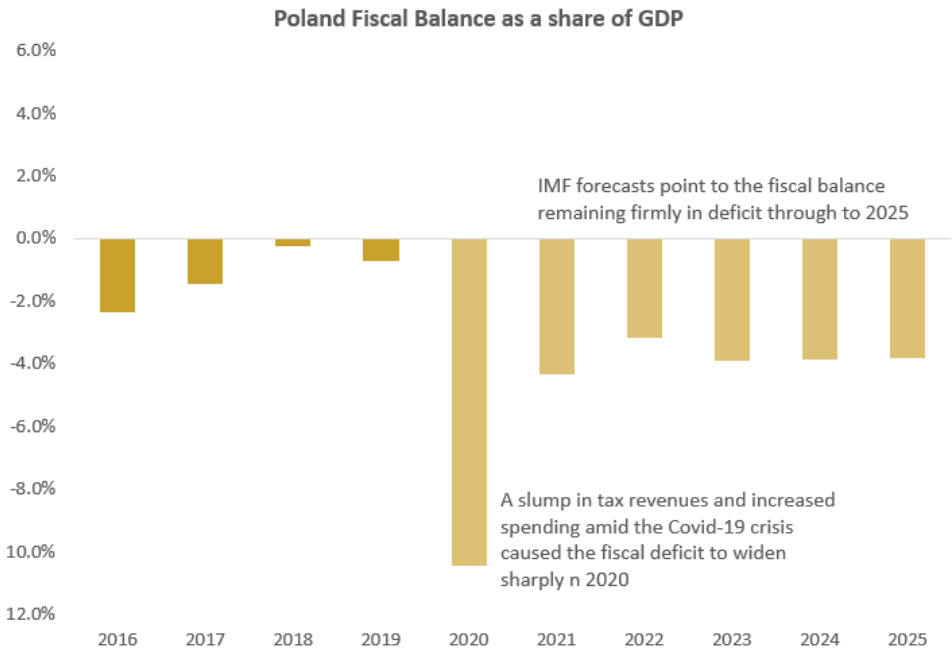
Fiscal Developments

The government deficit deteriorated strongly in 2020, owing to the fall in tax receipts, as well as the support measures brought in to mitigate the economic fallout of the pandemic. The cost of measures to cushion the impact of the crisis is estimated to have amounted to around 5.25% of GDP in 2020, with the biggest outlay likely to have come from loans granted to firms by the Polish Development Fund. Around two-thirds of these loans are projected to eventually be converted into grants, thus making a major contribution to the widening of the fiscal deficit. The recovering economy and the phasing out of anti-crisis measures should help the government to rein in the deficit significantly in 2022.



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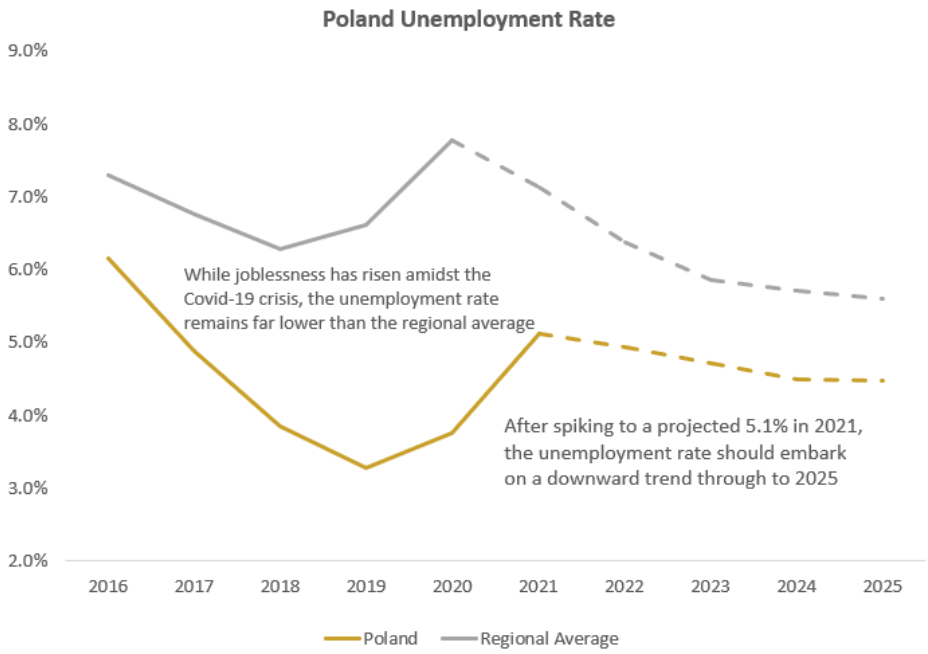
Unemployment

Poland's unemployment rate increased in 2020 as the COVID-19 pandemic led to a slump in demand and business activity. The jobless rate stood at 6.1% in December, up from 5.5% at the beginning of 2020, but nonetheless substantially lower than seen across the region on average. While the economy is expected to recover in 2021, unemployment is likely to rise further, as government support programmes are scaled back, and businesses continue to contend with high levels of uncertainty. Joblessness should resume a declining trend in 2022 as the economic recovery becomes more firmly entrenched.



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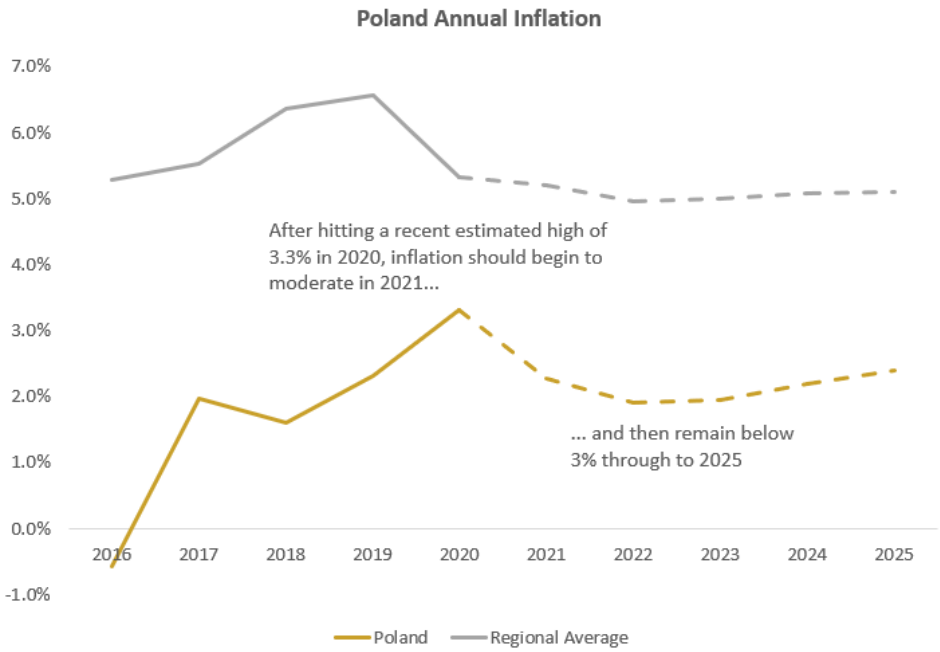
Inflation

Inflation rose to an estimated 3.3% in 2020 (from 2.3% in 2019), as higher operating costs associated with COVID-19 containment measures drove a spike in services prices, outweighing lower prices for goods and energy, which softened against the backdrop of the global economic downturn. Inflation should moderate back to pre-pandemic levels in 2021, as services price inflation decelerates, and wage costs are brought down by deteriorating labour market conditions.



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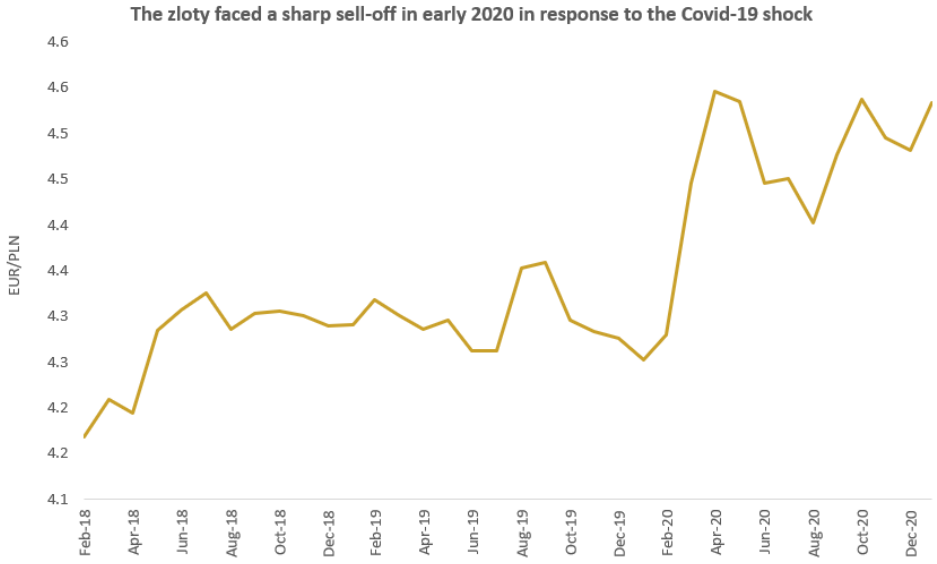
Currency Risk

The Polish zloty depreciated substantially against the euro in the first half of 2020, as global financial risk aversion spiked in reaction to the coronavirus fallout. Despite stabilising in the latter half of the year, the currency remains relatively weak, in part because of a very loose monetary policy stance. Indeed, the key policy interest rate was held at just 0.1% at the National Bank of Poland's (NBP) January meeting, and the bank could extend its quantitative easing (QE) programme this year. Moreover, central bank policymakers have vocalised their concerns over appreciation pressures on the zloty, and hinted that intervention to support the currency will be taken if required. The NBP is keen to avoid what it sees as excessive zloty strength, which hits exporters and can thus hinder the country's economic performance.



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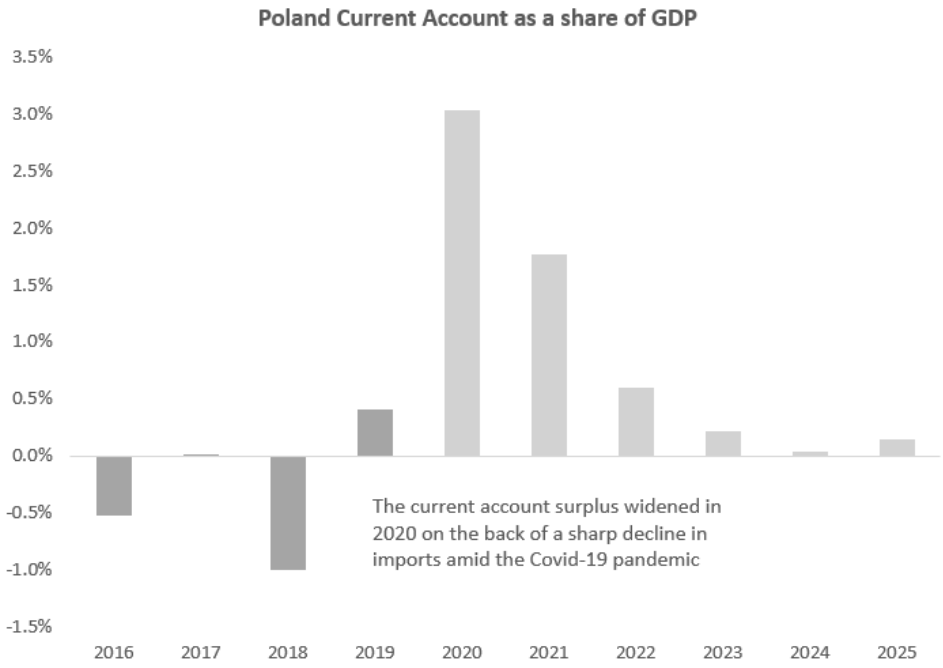
Poland's resilient current account performance is a supportive factor for the currency. In contrast to many of its peers, Poland saw its current account position strengthen in 2020, with the surplus widening to an estimated 3.0% of GDP (from 0.4% in 2019). The country's exports, which consist mainly of industrial products, have been less affected than those of many other nations (for example, those that rely heavily on services exports like business services and tourism). Meanwhile, subdued household consumption has kept a lid on imports. Looking ahead, the current account surplus is likely to shrink in the coming years, as recovering domestic demand leads to a rebound in imports.



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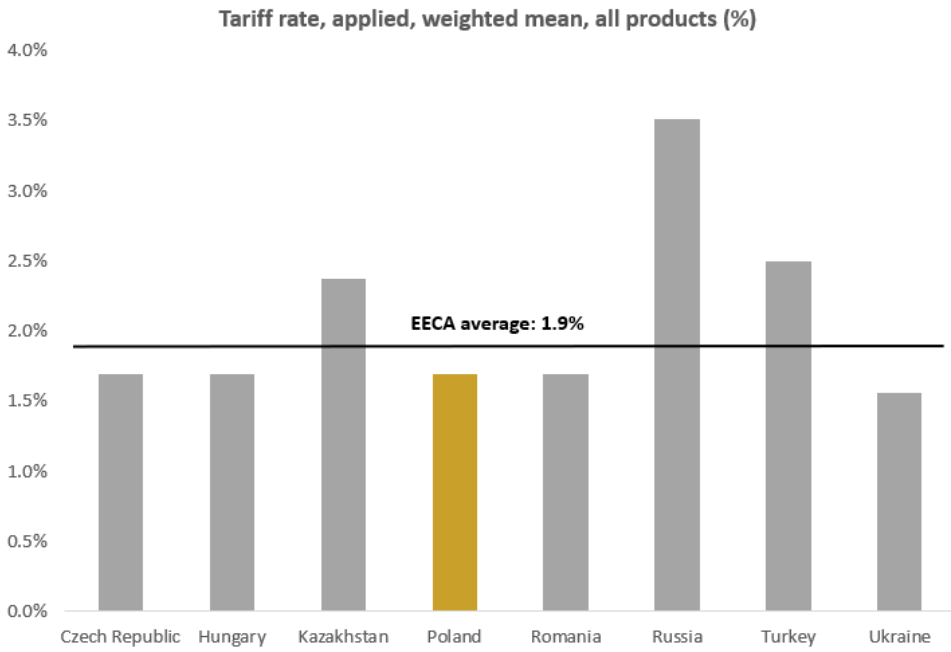
Trade Barriers

Poland's tariff barriers are generally lower than the average encountered in Eastern Europe & Central Asia. The applied weighted mean tariff rate was 1.7% in 2018, down from 2.0% in 2016. Poland joined the European Union in May 2004, and as such, external tariff rates are now set by the EU. Some industries, particularly agriculture, are protected under EU subsidies and tariffs. Poland is party to the European Union's Common Customs Tariff. As such, preferential rates apply to imports from countries the EU has signed agreements with.



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While non-tariff barriers can sometimes be burdensome, for example in the form of certain licensing requirements, Poland is ranked at a highly impressive first place (along with several other EU states) out of 190 economies globally for the category 'trading across borders' in the World Bank's *Doing Business 2020* report. According to the report, the time and costs associated with both exporting and importing in Poland are dramatically lower than in the OECD high income region on average.

		Poland	OECD high income
Time to export	Border compliance (hours)	0	12.7
	Documentary compliance (hours)	1	2.3
Cost to export	Border compliance (USD)	0	136.8
	Documentary compliance (USD)	0	33.4
Time to import	Border compliance (hours)	0	8.5
	Documentary compliance (hours)	1	3.4
Cost to import	Border compliance (USD)	0	98.1
	Documentary compliance (USD)	0	23.5

Source: World Bank; Baker Ing

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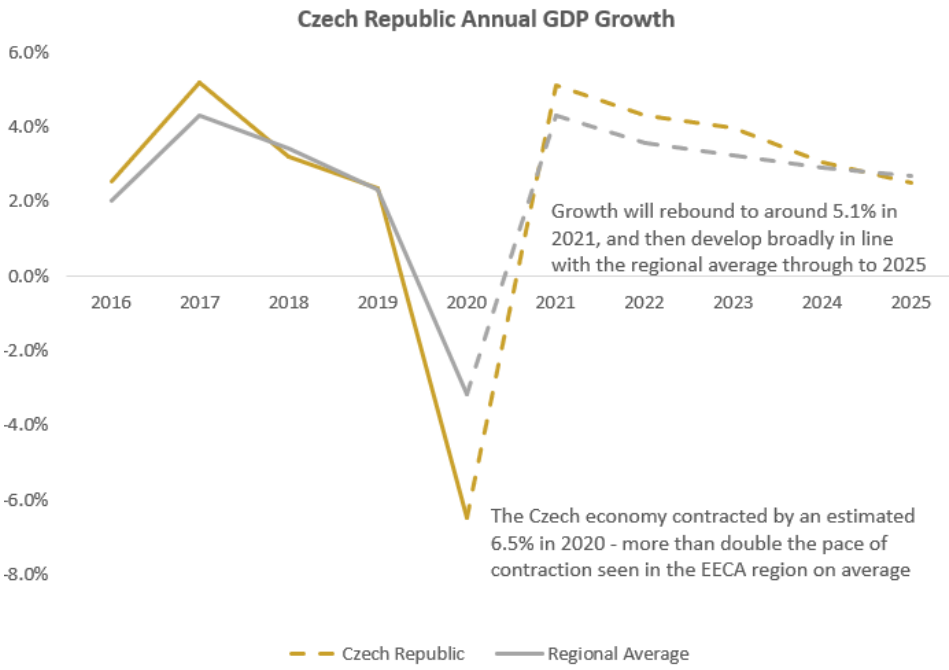
Czech Republic

Economic Growth

The economic shock resulting from the coronavirus crisis caused a substantial contraction in Czech GDP in 2020, given that the country has been one of the worst hit countries globally by the pandemic. The economy is estimated to have contracted by 6.5% – more than twice the regional average decline of 3.2%. After an unprecedented pace of decline in the first half of the year, as the economy felt the full force of the pandemic and related containment measures, GDP growth turned positive again in Q3. However, a major surge in new infections in the latter part of 2020, and a more recent surge in January (with lockdown measures now in place until at least mid-February), have put paid to any hopes of the recovery having continued through the turn of the year.

The economy should begin a more sustainable recovery in the second half of the year, as vaccine distribution progresses and confidence gradually improves. All in all, the IMF projects that GDP will expand by 5.1% in 2021 – which would be the fastest annual growth rate since 2017. However, much will depend on the evolution of the pandemic, the speed and efficacy of the vaccine distribution programme, and the effectiveness of government support measures.



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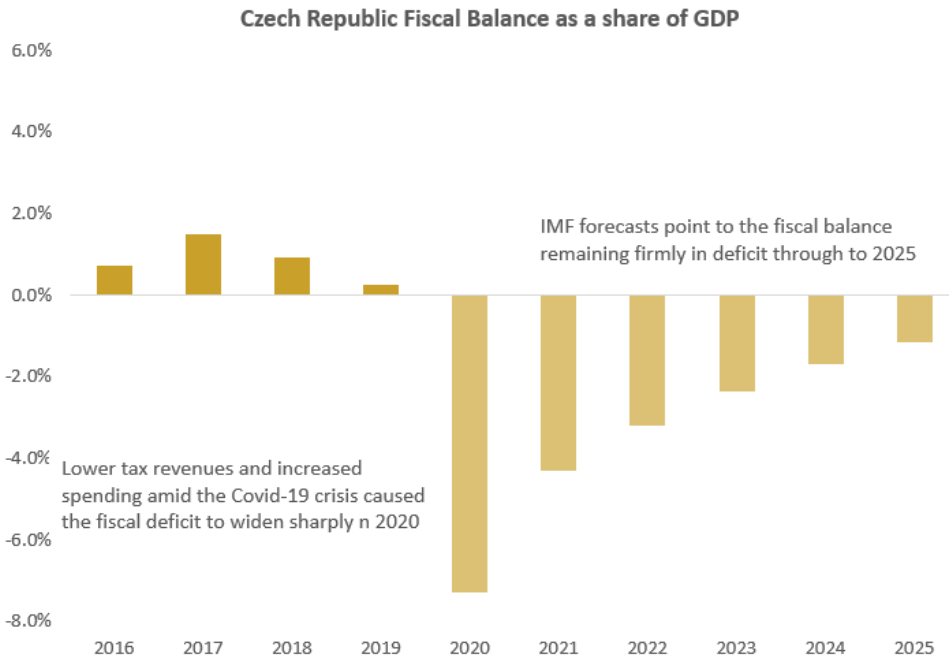
Fiscal Developments

The budget deficit soared to an estimated 7.3% of GDP in 2020, owing to the sharp rise in government spending and a decline in overall revenue as the impacts of the COVID-19 pandemic were felt across the economy. Fiscal consolidation will see the deficit reined in over the coming years, likely starting in 2021, but this is likely to be a slow process.



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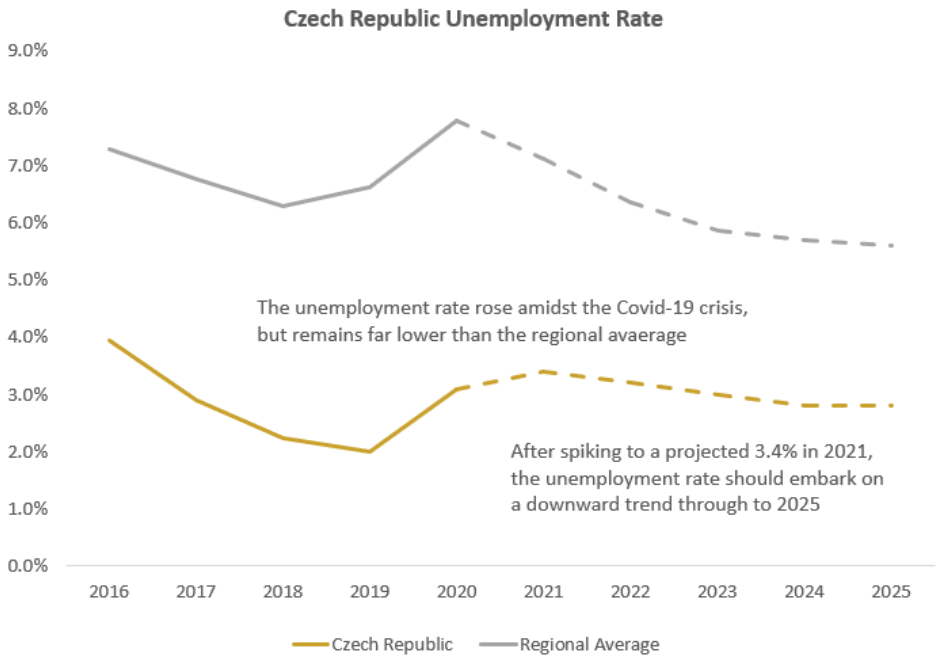
Unemployment

Unemployment is on the rise in the Czech Republic, as many businesses have been forced into bankruptcy amid lockdowns and declines in both domestic and foreign demand. Nevertheless, government support to mitigate job losses has helped to keep the unemployment rate far lower than in many regional counterparts. The government has provided generous wage subsidies to the firms most affected by the COVID-19 crisis, thus helping to avoid mass layoffs. Nevertheless, due to the recent surge in cases and the associated restrictions which are still in force, unemployment will likely rise slightly further in 2021 (to a projected 3.4% from an estimated 3.1% in 2020).

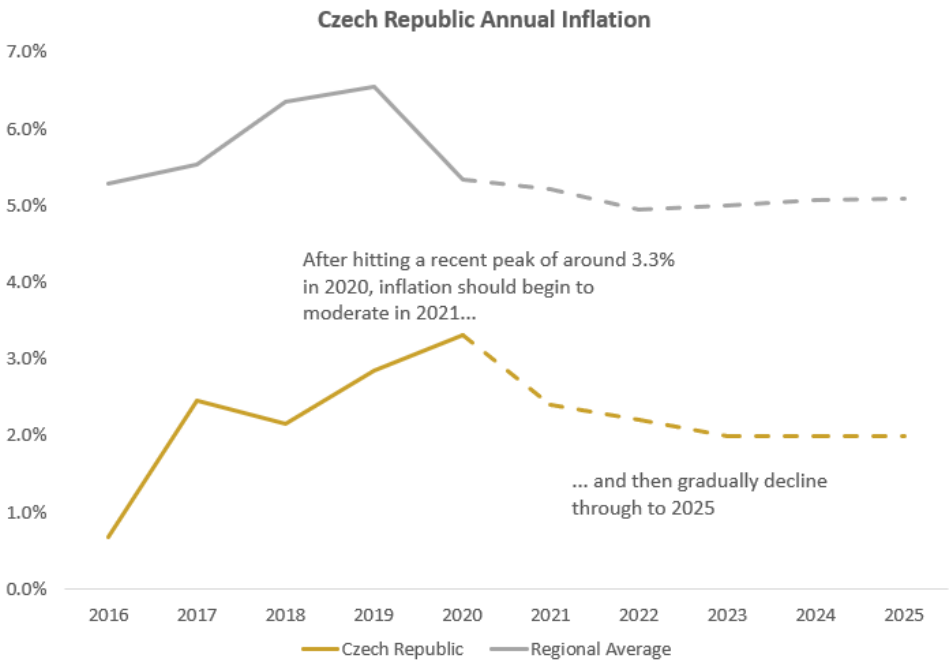


Source: IMF; Baker Ing
- 2020 data is estimated, and data for 2021 onwards is based on forecasts (indicated by the dashed lines).

Baker Ing

Inflation

Supply-side constraints, currency weakness and a spike in global food prices helped to drive Czech inflation higher in 2020, with average annual consumer price growth hitting an estimated 3.3%. However, inflation should begin to moderate this year as soft wage growth and weak domestic demand keep price pressures subdued.



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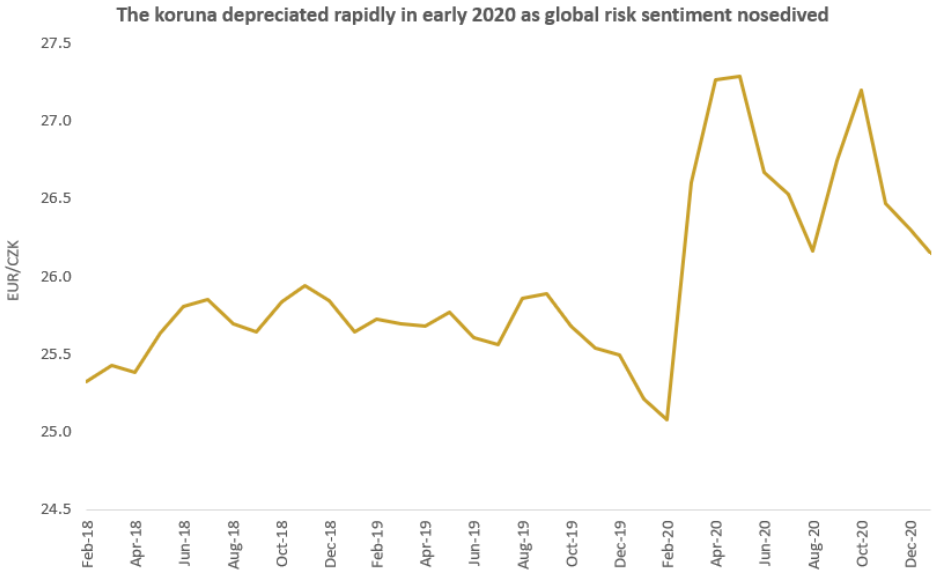
Currency Risk

The Czech koruna depreciated significantly in early 2020, and saw a further bout of depreciation later in the year, as the COVID-19 crisis caused risk sentiment to nosedive, triggering a flight to safety. In March, the koruna plunged to CZK27.8:EUR. After then appreciating modestly during the summer months, the second wave of the pandemic saw the currency fall back to around CZK27.2 in October. The koruna is likely to reverse some of its depreciation in 2021 as global risk sentiment improves, but the extent of any appreciation is likely to be limited as the pandemic persists.



Source: OFX.com; Baker Ing

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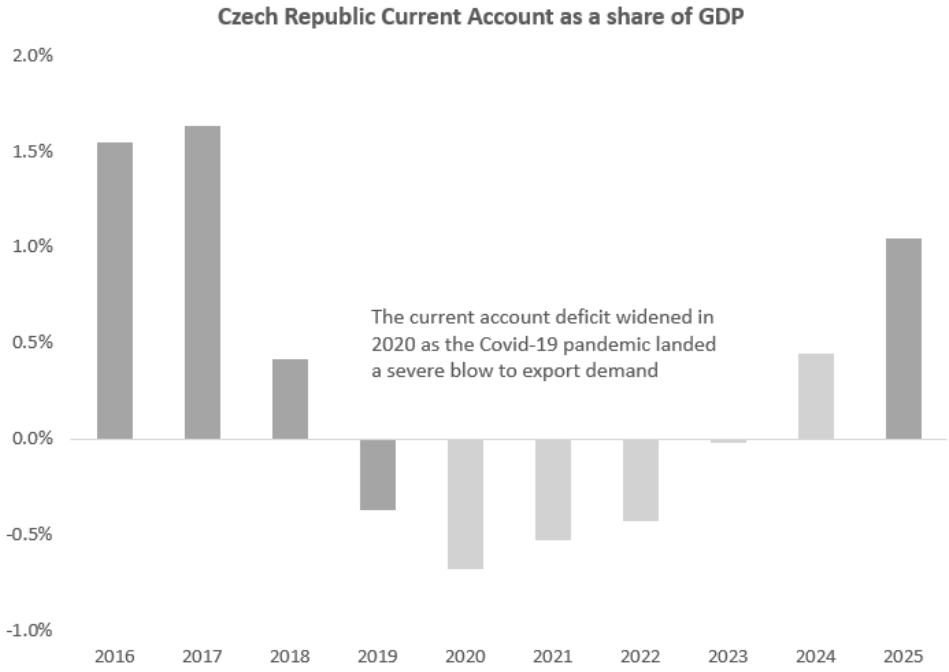
The Czech Republic's current account deteriorated in 2020, as the trade position worsened. The highly pro-cyclical nature of some of the country's key exports (such as automotives) meant that the pandemic-induced slump in global demand hit the Czech export sector hard. The export sector accounts for around three-quarters of Czech GDP, highlighting its importance to the country's overall economic performance. As the global economy strengthens, demand for Czech exports will pick up, helping to drive an improvement in the current account position over the coming years.



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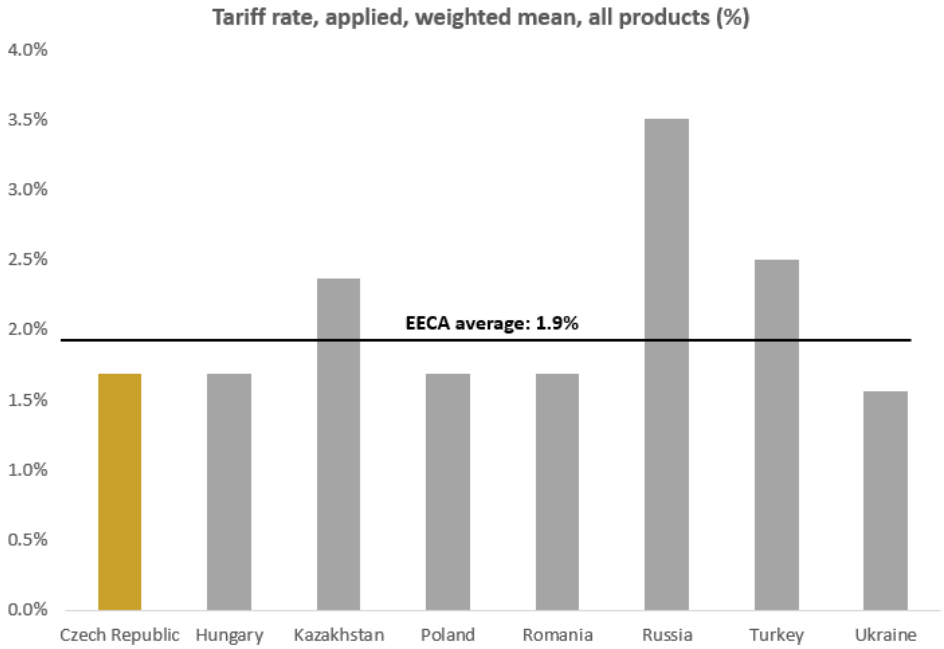
Trade Barriers

The Czech Republic's tariff barriers are generally lower than the average encountered in Eastern Europe & Central Asia. The applied weighted mean tariff rate was 1.7% in 2018. As with Poland, the Czech Republic joined the European Union in 2004, and as such, external tariff rates are now set by the EU. Some industries, particularly agriculture, are protected under EU subsidies and tariffs. The Czech Republic is party to the European Union's Common Customs Tariff. As such, preferential rates apply to imports from countries the EU has signed agreements with.



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Along with Poland and several other EU states, the Czech Republic is ranked first place out of 190 economies globally for the category 'trading across borders' in the World Bank's *Doing Business 2020* report. According to the report, the time and costs associated with both exporting and importing in Poland are far lower than in the OECD high income region on average. While import licences are not required for most goods, certain items are still subject to an automatic licensing system.

		Czech Republic	OECD high income
Time to export	Border compliance (hours)	0	12.7
	Documentary compliance (hours)	1	2.3
Cost to export	Border compliance (USD)	0	136.8
	Documentary compliance (USD)	0	33.4
Time to import	Border compliance (hours)	0	8.5
	Documentary compliance (hours)	1	3.4
Cost to import	Border compliance (USD)	0	98.1
	Documentary compliance (USD)	0	23.5

Source: World Bank; Baker Ing

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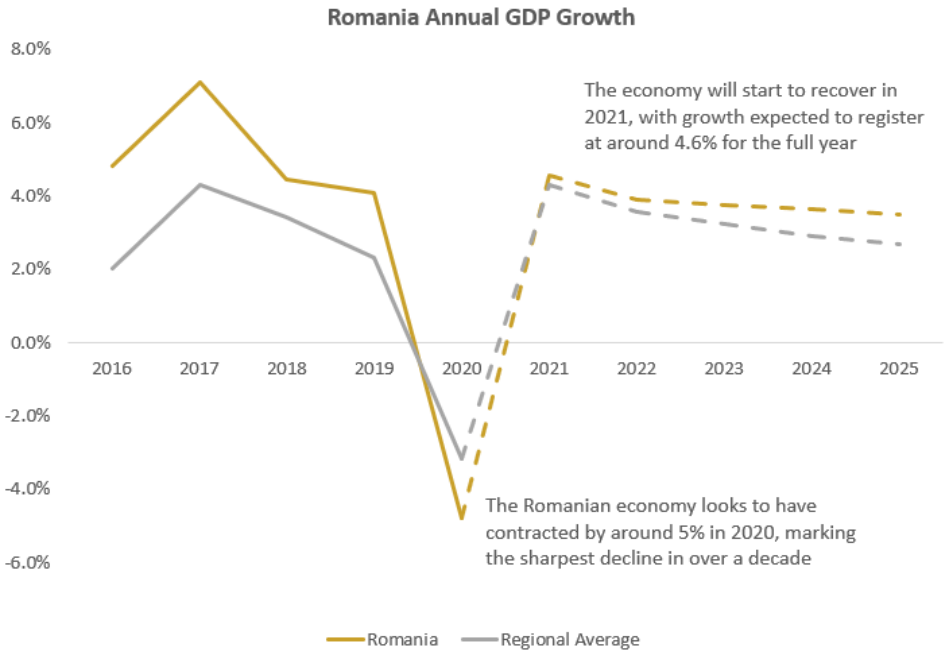
Romania

Economic Growth

The Romanian economy appears to have contracted at its sharpest pace in over a decade in 2020 (by an estimated 4.8%). The COVID-19 pandemic prompted strict lockdown measures, which had a sharply negative impact on consumer spending. Moreover, the disruption to international supply chains and the feeble external demand environment sent exports plummeting. A second wave of the pandemic prompted the authorities to reintroduce social restriction measures in late 2020, many of which are due to remain in place until at least mid-February. As such, the economy is likely to continue to struggle in the first quarter of 2021, before gradually picking up steam as vaccines become more widely available later in the year. All in all, the IMF forecasts that the economy will post full-year growth of around 4.6% in 2021. However, given the great level of uncertainty surrounding how the pandemic will evolve, the risks to this outlook are significant. Indeed, further spikes in infection rates, coupled with delays in vaccine rollout, could result in further social restriction measures, and thus weigh on the extent of the recovery this year.



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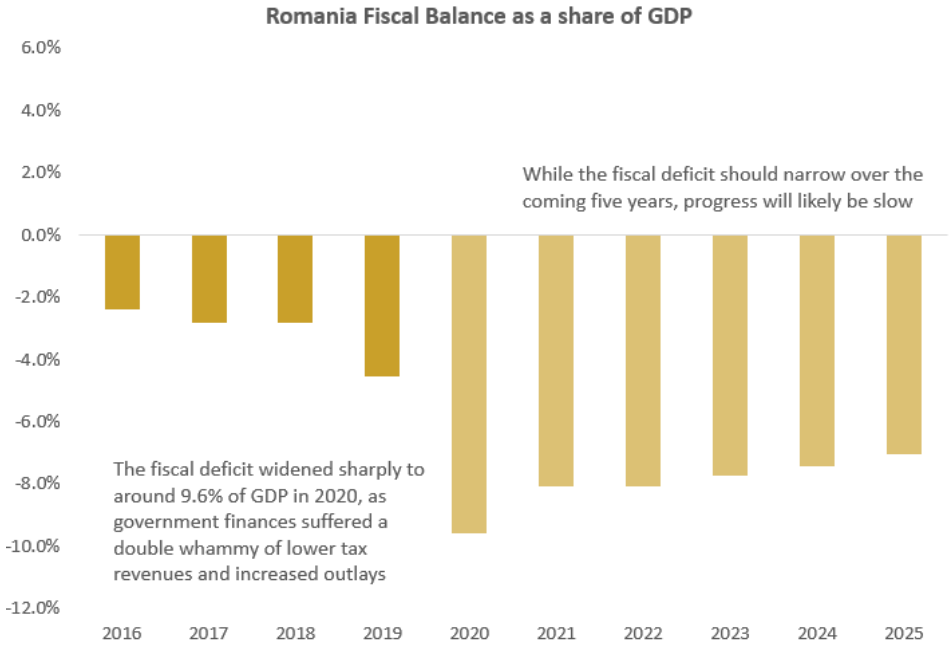
Fiscal Developments

The fiscal deficit is estimated to have widened to around 9.6% of GDP in 2020. A double whammy of lower tax revenues, along with big spending increases to help provide some relief to households and businesses from the impacts of the coronavirus crisis, has hurt government finances.



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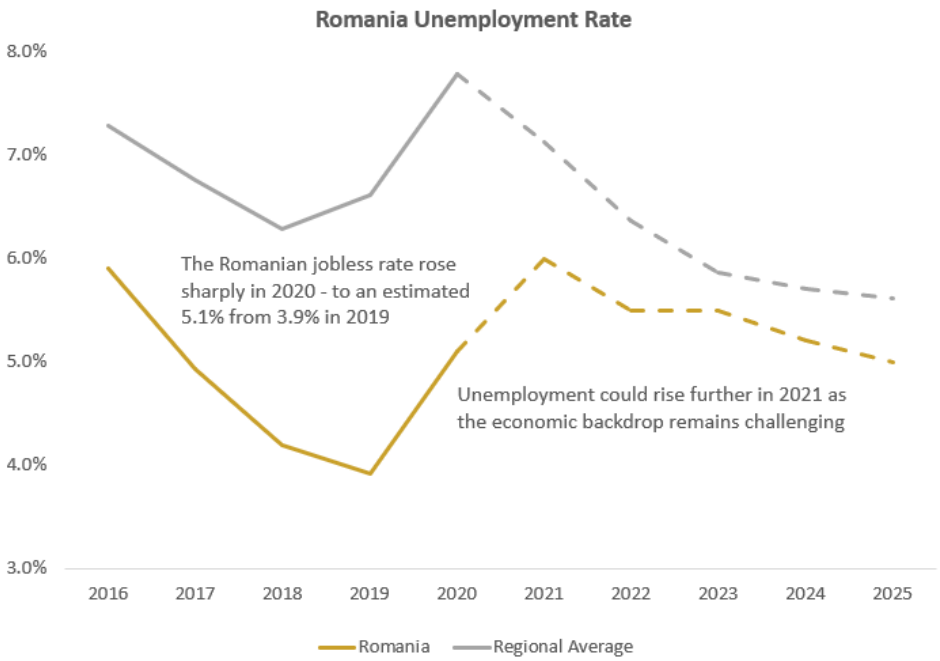
Unemployment

The unemployment rate spiked higher in 2020, to an estimated 5.1%, up from 3.9% in 2019. It is likely to increase further in 2021 as businesses continue to struggle in the context of the ongoing pandemic, and as employment support schemes are potentially curtailed. Thereafter, the unemployment rate should resume moderating as economic fundamentals improve.



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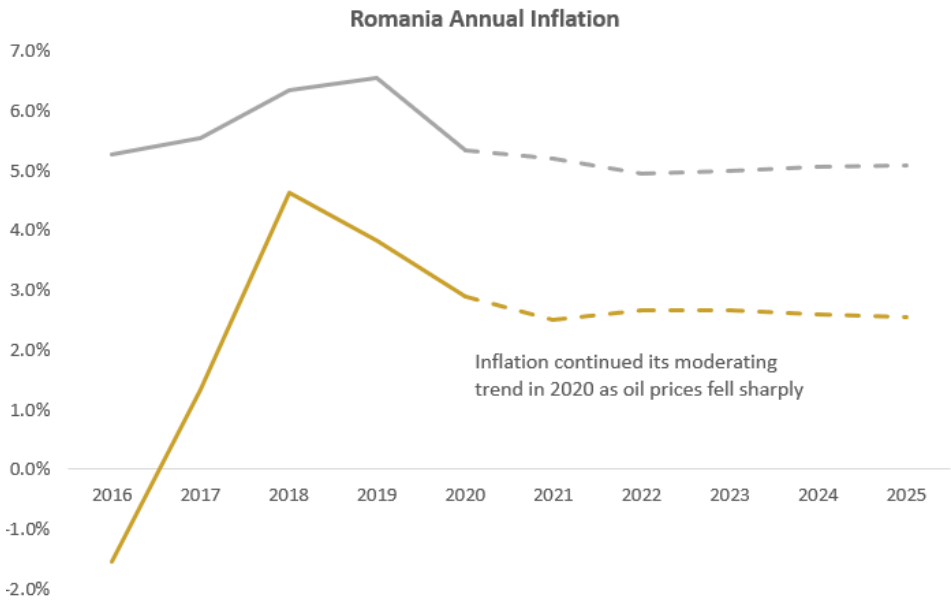
Inflation

The sharp fall in global oil prices in 2020 helped to reduce Romania's import bill and contributed to inflation moderating to an estimated annual rate of just under 3% (down by roughly a full percentage point from 2019). The weak domestic demand backdrop was another source of downward pressure on inflation last year, and will continue to be so in 2021. Indeed, inflation is projected to cool further this year, to an average annual rate of approximately 2.5%.



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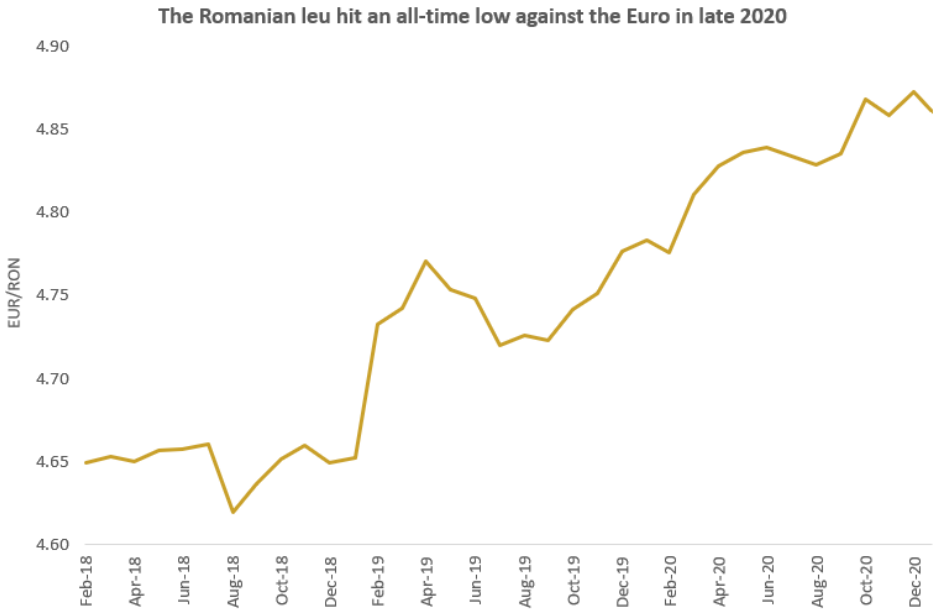
Currency Risk

Despite central bank interventions to stem its decline, the Romanian leu depreciated to an all-time low against the Euro in late 2020. This was driven by a number of factors, including: heightened global risk aversion, which drove investors to seek safe haven assets; a decline in foreign investment as the COVID-19 crisis took hold; monetary easing from the central bank; and a widening current account deficit. While improving risk sentiment should offer some support going forward, the currency is likely to come under further depreciation pressure this year.



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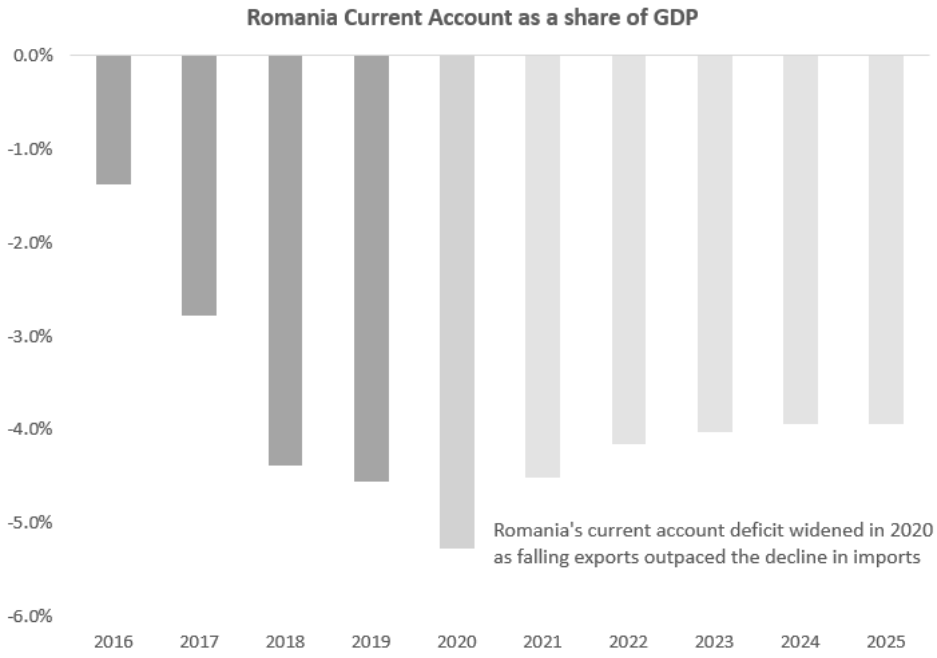
Supply chain disruptions and the slump in demand across key trading partners caused exports to fall sharply in 2020, outpacing the drop in imports, and leading the current account deficit to widen to around 5.3% of GDP. While a recovery in global demand will see the export sector start to pick up steam in 2021, helping to improve the current account situation, it will nevertheless remain firmly in deficit. Import demand will gradually recover as the domestic backdrop brightens, while the import bill will also increase on the back of recovering global energy prices.



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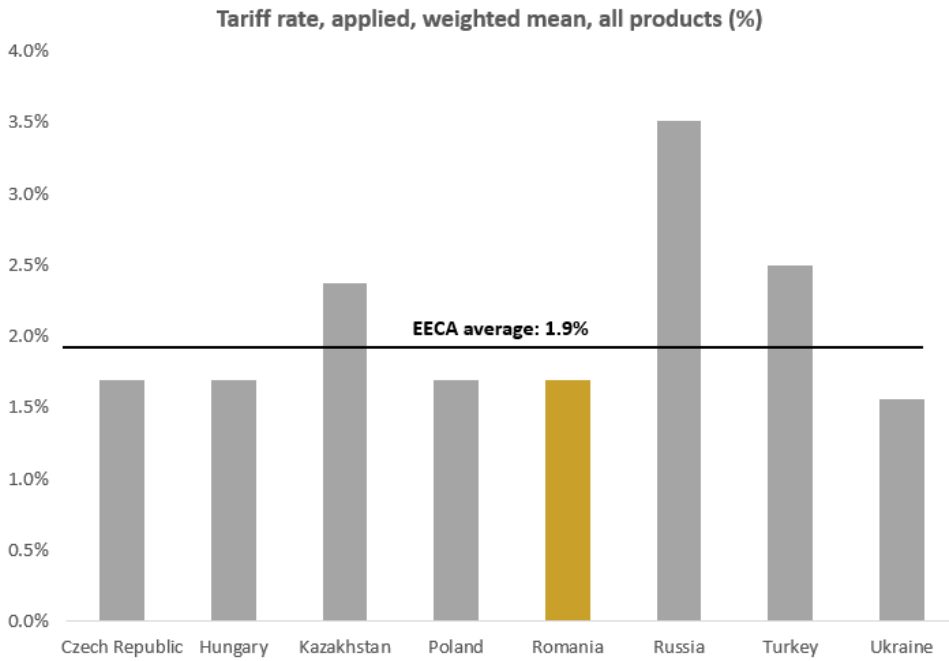
Trade Barriers

As is the case with Poland, the Czech Republic and Hungary, Romanian external tariff rates are now set by the EU, following the country's accession to the European Single Market in 2007. As such, its applied weighted mean tariff rate was 1.7% in 2018 (latest data available).



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Baker Ing

Along with several other EU states, Romania is ranked first place out of 190 economies globally for the category 'trading across borders' in the World Bank's *Doing Business 2020* report. The time and costs associated with both exporting and importing in Romania are far lower than the Europe & Central Asia and OECD high income region averages. Nevertheless, exporters based outside the EU can still encounter difficulties when sending goods to Romania, such as demands for bribes from customs officials.

		Romania	OECD high income
Time to export	Border compliance (hours)	0	12.7
	Documentary compliance (hours)	1	2.3
Cost to export	Border compliance (USD)	0	136.8
	Documentary compliance (USD)	0	33.4
Time to import	Border compliance (hours)	0	8.5
	Documentary compliance (hours)	1	3.4
Cost to import	Border compliance (USD)	0	98.1
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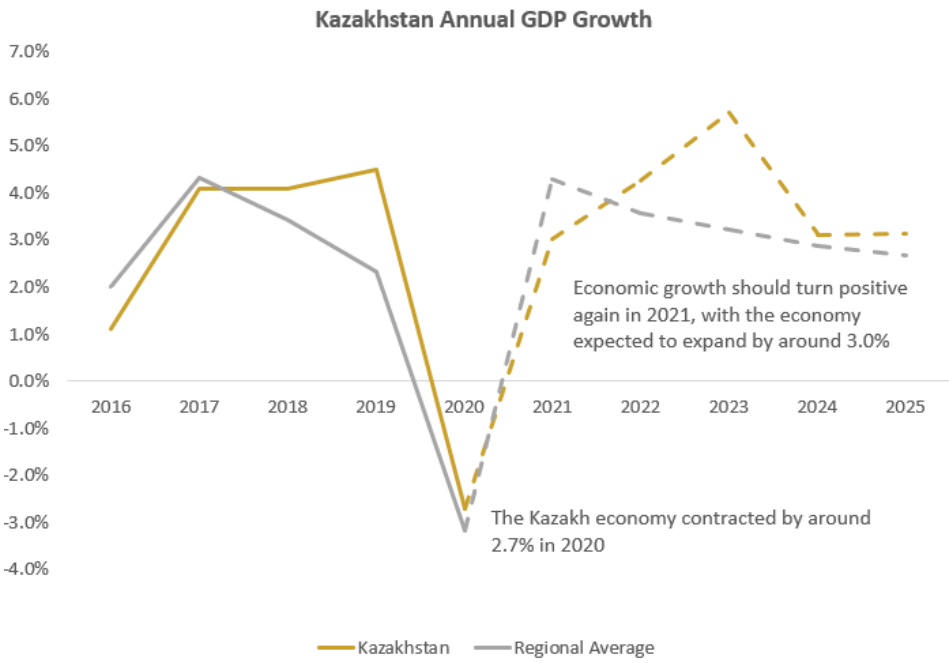
Kazakhstan

Economic Growth

After strong growth of 4.5% in 2019, Kazakhstan's GDP contracted by around 2.7% in 2020, on the back of the pandemic-driven drop in global energy prices and demand, as well as the hit to domestic activity caused by two national lockdowns and quarantine restrictions. Nevertheless, the extent of the downturn in Kazakhstan has been less severe than that experienced by many of its regional peers, thanks in no small part to substantial government support measures. Looking ahead, the economy is expected to see GDP growth of around 3.0% in 2021, helped by increasing oil prices and recovering global energy demand. Moreover, global vaccine rollouts will help to bolster demand both domestically and across Kazakhstan's key export markets.



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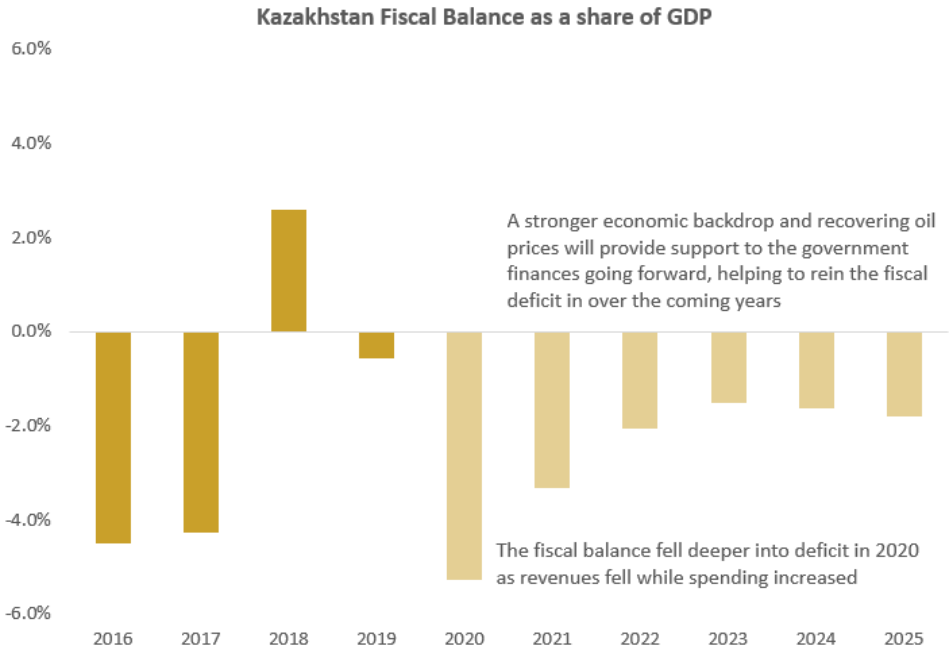
Fiscal Developments

The Kazakh government's large anti-crisis package has helped to limit the economic fallout of the COVID-19 crisis. However, the significant increase in spending to support households and businesses, coupled with falling tax receipts, caused the fiscal deficit to widen significantly in 2020. Transfers from Kazakhstan's sovereign wealth fund, which holds ample assets thanks to the accumulation of past oil revenues, helped to prevent the deficit from widening even further. Looking ahead, the fiscal deficit should begin to contract in 2021, as recovering oil prices and a stronger economic backdrop help to replenish revenues.



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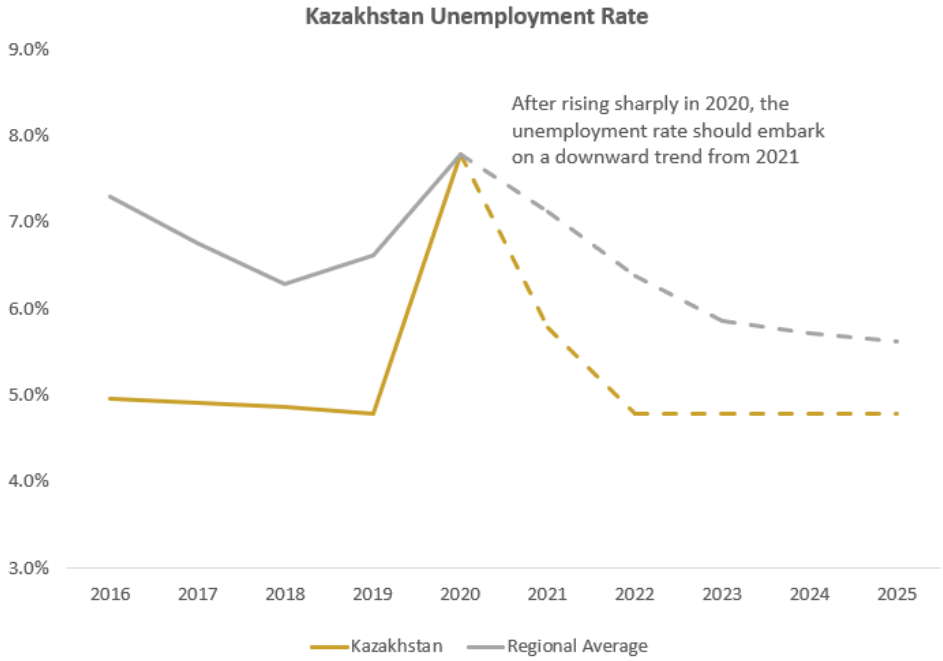
Unemployment

Kazakhstan's unemployment rate is estimated to have risen steeply in 2020, as many businesses were forced to close or scale back activity, in an environment of sharply lower domestic and external demand, as the COVID-19 pandemic hit local and global activity. As the Kazakh economy strengthens and activity also picks up across its key export markets, the labour market situation should improve in 2021, with unemployment projected to fall back below the regional average.



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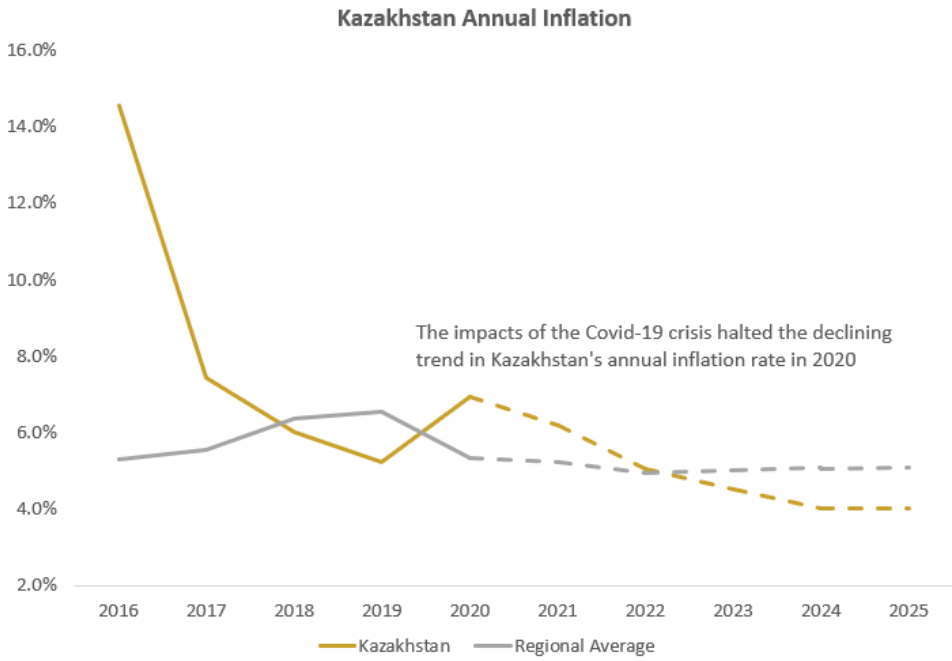
Inflation

The COVID-19 driven slump in global commodity prices caused the Kazakh currency to depreciate in 2020, which in turn stoked imported inflation. As such, Kazakhstan's annual inflation rate ticked up to approximately 6.9% last year (from 5.2% in 2019), breaking from the moderating trend of recent years. As global commodity prices recover in 2021, the currency should find some support, and in turn, inflation is likely to resume its declining trend this year.



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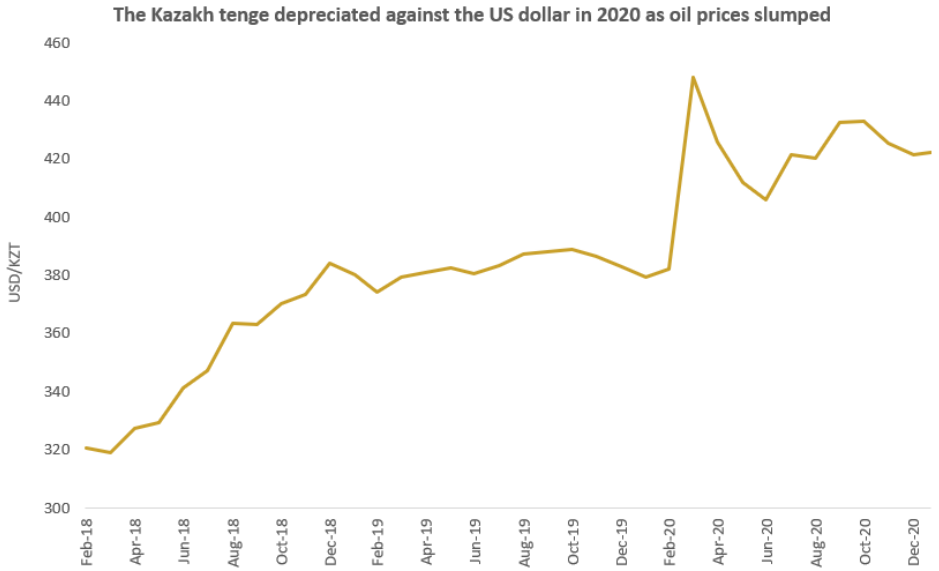
Currency Risk

The Kazakh tenge lost about 9% of its value against the US dollar in 2020, as the prices of oil and gas – the country's main exports – slumped as global energy demand plummeted amid the COVID-19 crisis. Stronger oil prices should lead to a moderate appreciation of the tenge in 2021. However, the extent of any appreciation will be limited by relatively subdued economic growth and still-cautious investor sentiment.



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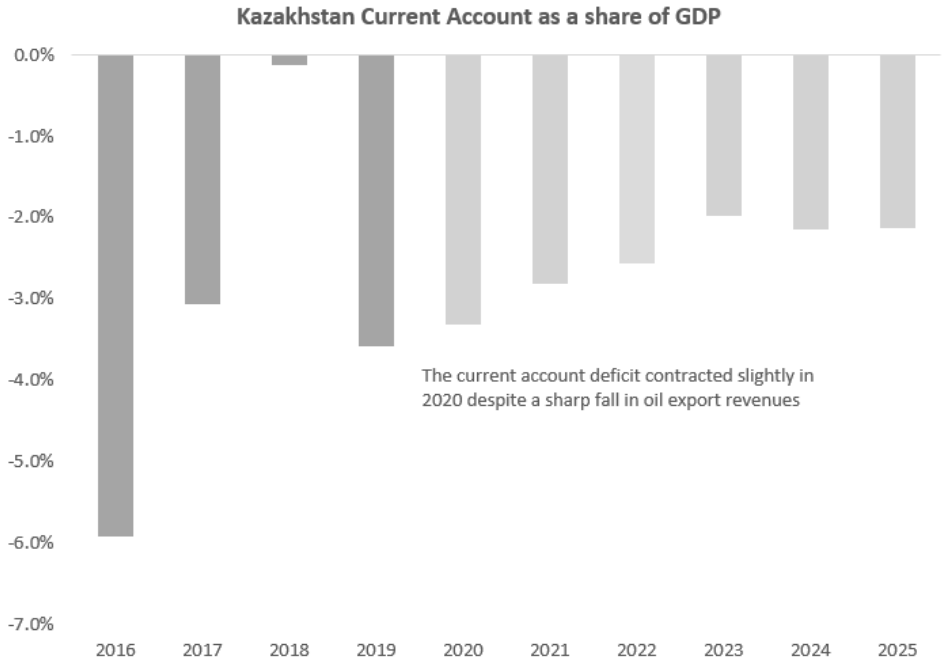
Despite the hit to oil export revenues caused by the slump in global oil prices, Kazakhstan's current account deficit as a share of GDP contracted slightly in 2020. This was partly due to a big fall in imports, as domestic demand stuttered as a result of the COVID-19 crisis. Going forward, recovering oil prices should help the current account deficit to narrow further in 2021.



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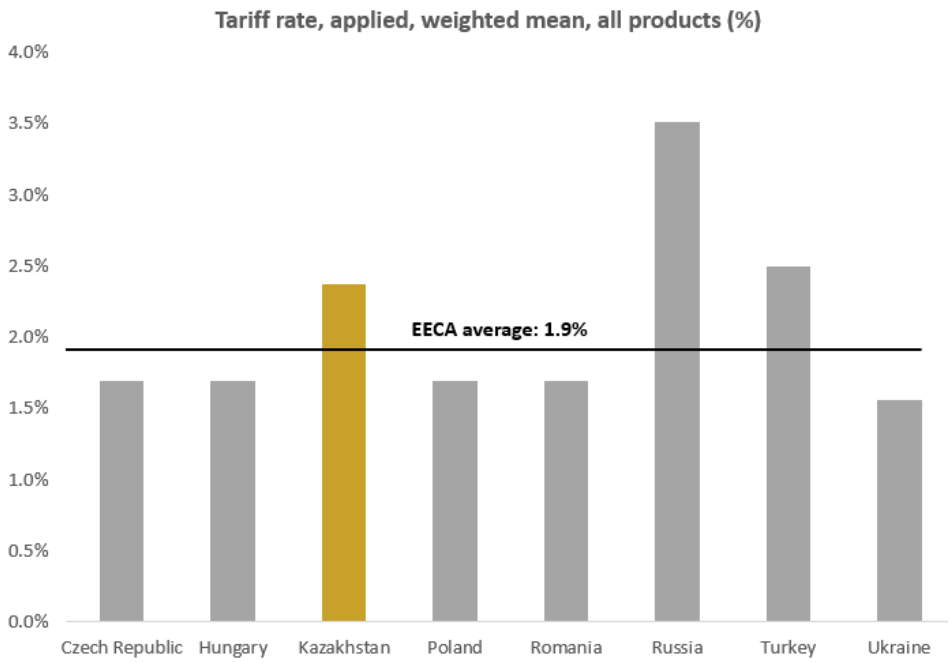
Trade Barriers

Kazakhstan's tariff barriers are relatively high compared to the average encountered in Eastern Europe & Central Asia. The applied weighted mean tariff rate was 2.4% in 2018 (latest data available) – 0.5 percentage points above the regional average of 1.9%.



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In addition, Kazakhstan's non-tariff barriers are also significant. In the World Bank's *Doing Business 2020* report, Kazakhstan is ranked at a disappointing 105th out of 190 economies globally for the category 'trading across borders.' According to the report, while importing is generally a faster and cheaper process in Kazakhstan than in its regional peers, the time and cost of exporting are much higher.

		Kazakhstan	Europe & Central Asia
Time to export	Border compliance (hours)	105	16.1
	Documentary compliance (hours)	128	25.1
Cost to export	Border compliance (USD)	470	150
	Documentary compliance (USD)	200	87.6
Time to import	Border compliance (hours)	2	20.4
	Documentary compliance (hours)	6	23.4
Cost to import	Border compliance (USD)	0	158.8
	Documentary compliance (USD)	0	85.9

Source: World Bank; Baker Ing

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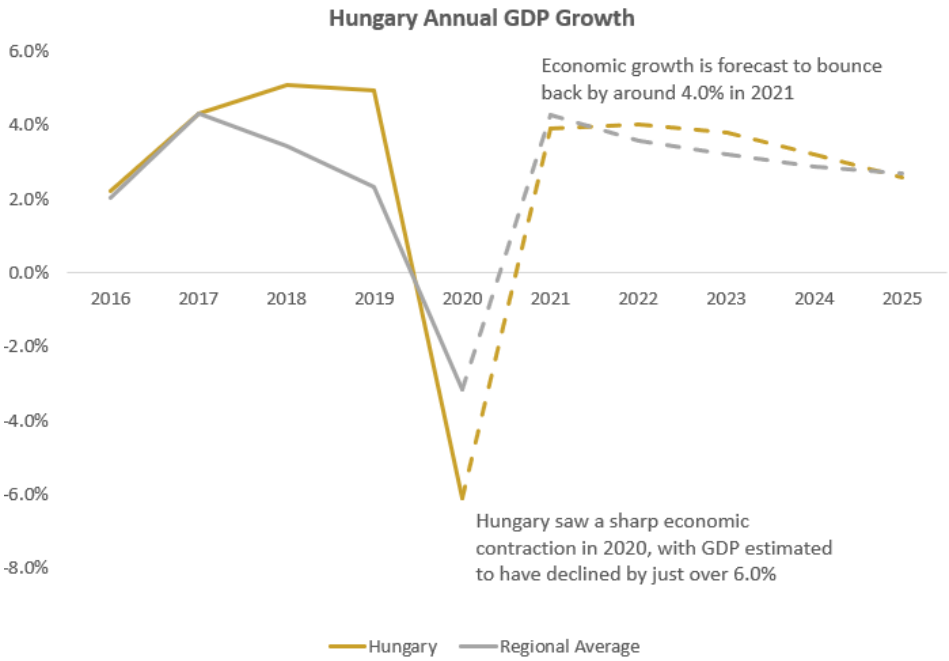
Hungary

Economic Growth

COVID-19 interrupted a period of robust growth in Hungary. Indeed, the economy expanded by an average rate of 4.8% during 2017-2019. But the outbreak of the pandemic, and the accompanying restrictions on the movement of people and goods, led to GDP plummeting by an estimated 6.1% in 2020. Hungary's exposure to highly cyclical industries (such as automotives), as well as its reliance on tourism, left it in a more vulnerable position than many of its regional peers.

Hopes that a recovery would begin to take hold in early 2021 were dashed in the autumn, as the second wave of the coronavirus has hit the country harder than the first. The government decided in mid-January to extend existing lockdown measures until at least the beginning of February. With infection rates still high and vaccine rollout not proceeding as quickly as had been hoped, further extensions cannot be ruled out. As such, economic activity is unlikely to pick up significantly until the second half of the year. Nevertheless, full-year economic growth of 3.9% is expected in 2021, as consumer spending rebounds, external demand strengthens on the back of the reopening of the global economy, and EU funds provide additional support. Risks to this outlook are elevated however, as the unpredictable evolution of the COVID-19 pandemic could put a spanner in the works.



Source: IMF; Baker Ing
- 2020 data is estimated, and data for 2021 onwards is based on forecasts (indicated by the dashed lines).

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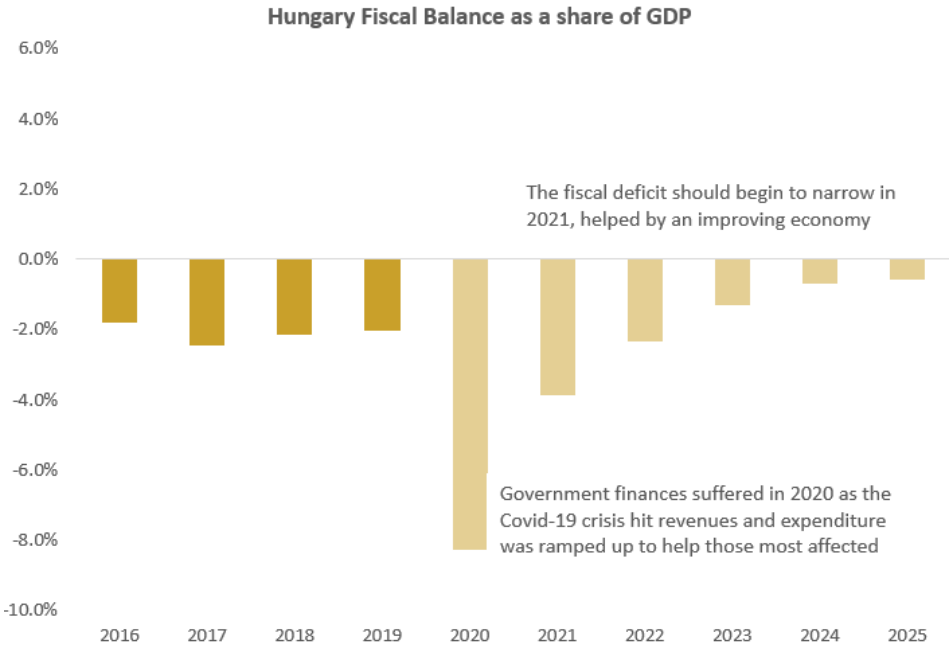
Fiscal Developments

The sharp economic downturn in 2020, and the measures enacted to mitigate the socioeconomic impacts of the pandemic, have put a heavy strain on Hungary's public finances. The fiscal deficit as a share of GDP is estimated to have hit 8.3% in 2020. The deficit should begin to narrow in 2021, driven by the economic recovery and the expiry of emergency support measures.



Source: IMF; Baker Ing
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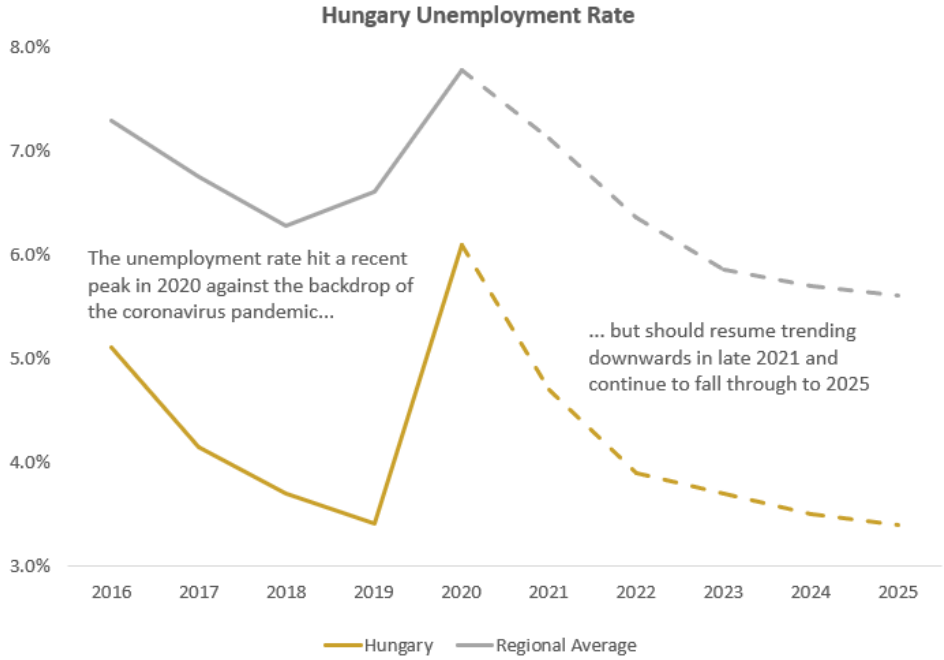
Unemployment

The unemployment rate embarked on a rising trend in 2020, with many companies having been forced to make layoffs as demand for goods and services plummeted. The IMF is forecasting that the jobless rate should begin to moderate in 2021. However, the expiry of employment support measures, such as a temporary wage subsidy programme, could trigger a second wave of layoffs this year.



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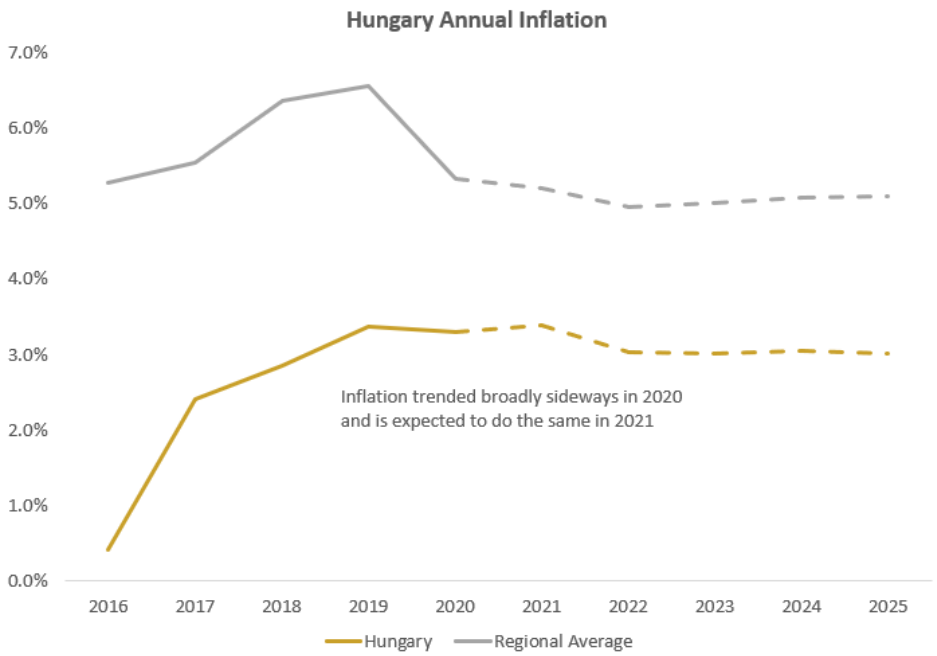
Inflation

Inflation appears to have stayed broadly steady on an annual basis, after registering at 3.4% in 2019. While consumer price growth spiked at the beginning of 2020, the slump in demand and sharp fall in oil prices dampened inflation, offsetting the impact of a weaker forint. Although higher oil prices and improving demand will put some upward pressure on inflation this year, any acceleration is likely to be very mild, given the still soft economic backdrop and muted wage growth.



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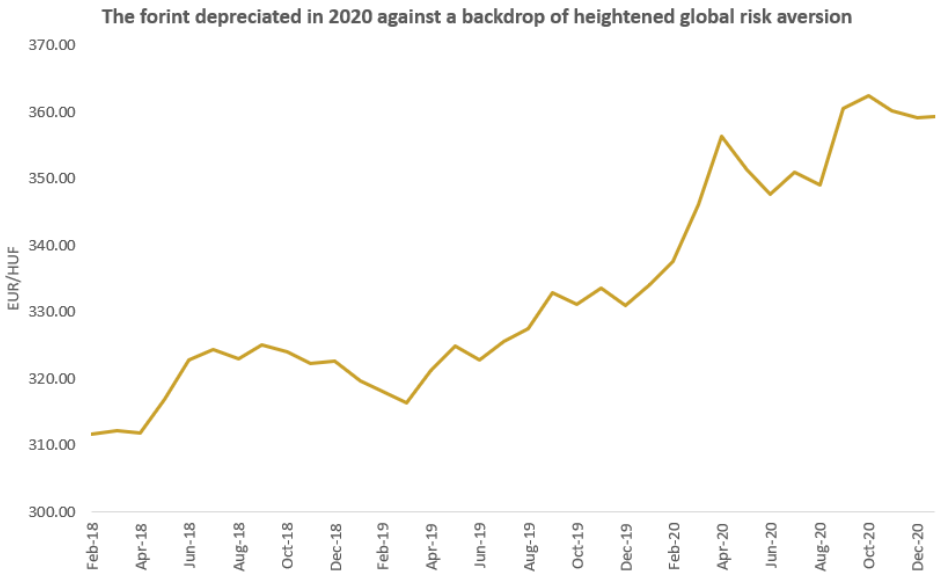
Currency Risk

Heightened global risk aversion drove the Hungarian forint lower in 2020, with interest rate cuts from the central bank applying further depreciatory pressure on the currency. The forint depreciated by around 8.5% against the euro last year. While a recovery in risk appetite should help to offer some support to the currency in 2021, the extent of any appreciation is likely to be limited, given that investors are still cautious and interest rates remain low.



Source: OFX.com; Baker Ing

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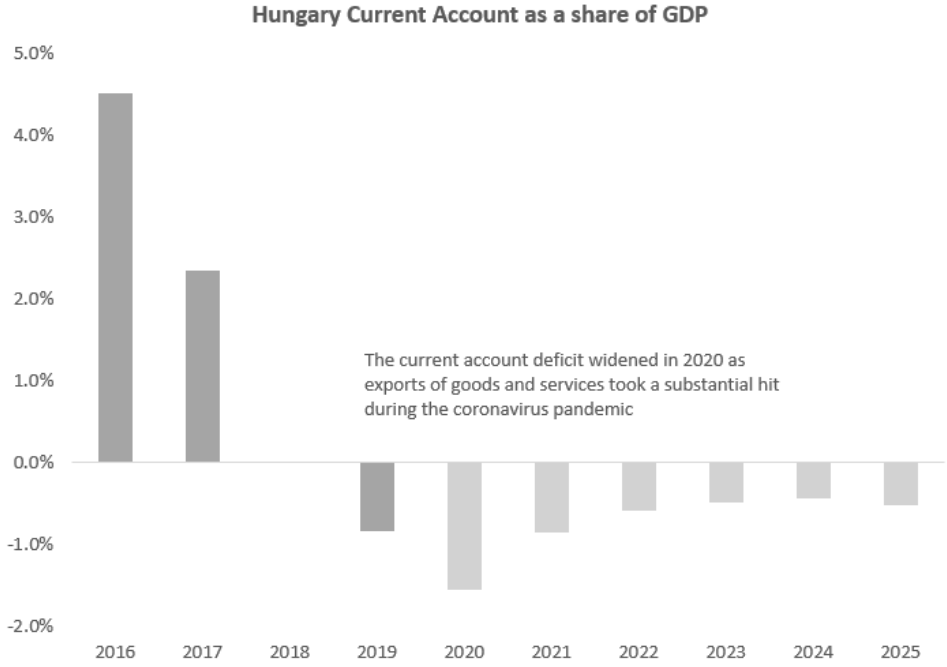
Hungary's current account deficit widened to an estimated 1.6% of GDP in 2020, from 0.8% in 2019. Exports of goods and services took a substantial hit during the coronavirus pandemic. Improved cost competitiveness (on the back of the forint's recent depreciation), along with a gradually improving global backdrop, will help to spur demand for Hungary's exports going forward. However, tourism will continue to struggle in 2021, and as such, this will limit the extent to which the current account deficit narrows this year.



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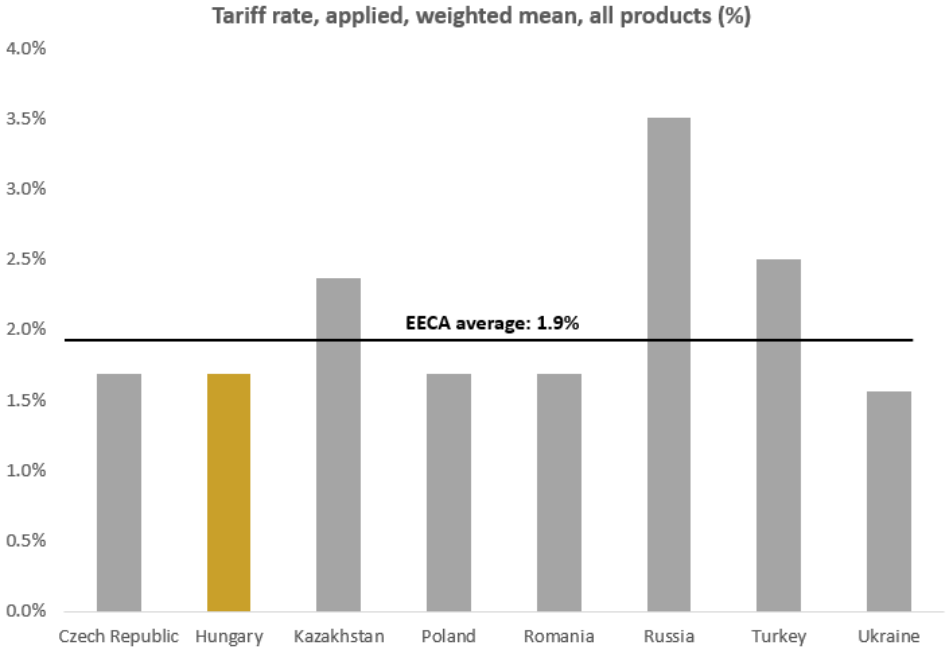
Trade Barriers

Hungary joined the European Union in 2004. As such, external tariff rates are now set by the EU. As per the latest available data (2018), Hungary's applied weighted mean tariff rate is 1.7%.



Source: World Bank; Baker Ing
- The weighted mean applied tariff is the average of effectively applied rates weighted by the product import shares corresponding to each partner country.
- Data is latest available (2018)
- The EECA average is an average of the tariff rate for all countries in the region for which 2018 data is available. This excludes Armenia, Azerbaijan, Georgia, Moldova, Montenegro, Serbia, Tajikistan, Turkmenistan, and Uzbekistan.

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Hungary (along with several other EU states) is ranked first place out of 190 economies globally for the category 'trading across borders' in the World Bank's *Doing Business 2020* report. The time and costs associated with both exporting and importing in Hungary are much less than the Europe & Central Asia and OECD high income region averages.

		Hungary	OECD high income
Time to export	Border compliance (hours)	0	12.7
	Documentary compliance (hours)	1	2.3
Cost to export	Border compliance (USD)	0	136.8
	Documentary compliance (USD)	0	33.4
Time to import	Border compliance (hours)	0	8.5
	Documentary compliance (hours)	1	3.4
Cost to import	Border compliance (USD)	0	98.1
	Documentary compliance (USD)	0	23.5

Source: World Bank; Baker Ing

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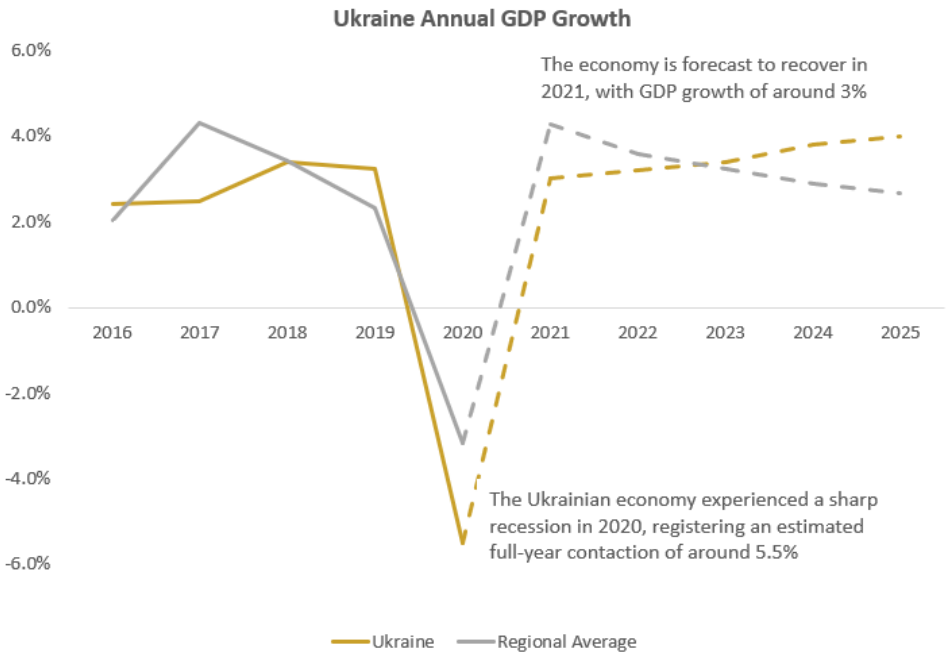
Ukraine

Economic Growth

Ukrainian GDP contracted by an estimated 5.5% on an annual basis in 2020, as the outbreak of the COVID-19 pandemic and strict quarantine measures sent the economy into a tailspin. While the recession began to ease in the third quarter amid the easing of containment measures, a second wave of the pandemic led to a spike in infections in late 2020, prompting authorities to reintroduce stricter social distancing and lockdown measures. This will dampen the pace of recovery in early 2021, with any significant pick-up in economic activity unlikely to kick in before the second half of the year. Indeed, the IMF is projecting a relatively muted recovery this year, with annual GDP growth expected to come in at around 3.0%.

Moreover, a number of risks hang over the outlook. The uncertainty over the course of the pandemic continues to plague business and consumer confidence. Meanwhile, the government has still not managed to kick-off its mass vaccination drive, having yet to secure sufficient doses. Indeed, it currently appears likely that Ukraine will be one of the last countries in the region to see a vaccine become widely available to the general public.



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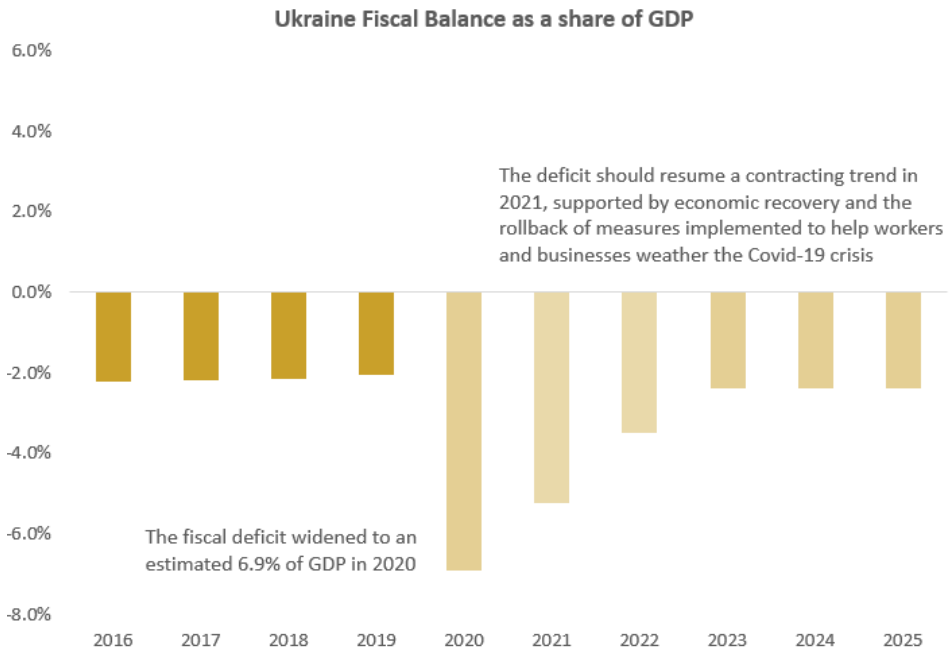
Fiscal Developments

The fiscal deficit looks to have widened significantly in 2020, to an estimated 6.9% of GDP. Fiscal pressures intensified as a result of falling revenues, additional spending on COVID-19 support measures, and large debt repayments coming due. Government finances should improve in 2021 as the authorities rollback pandemic-related support schemes and as the recovery in economic growth supports tax receipts. Nevertheless the fiscal balance looks set to remain in deficit territory through to 2025 at least.



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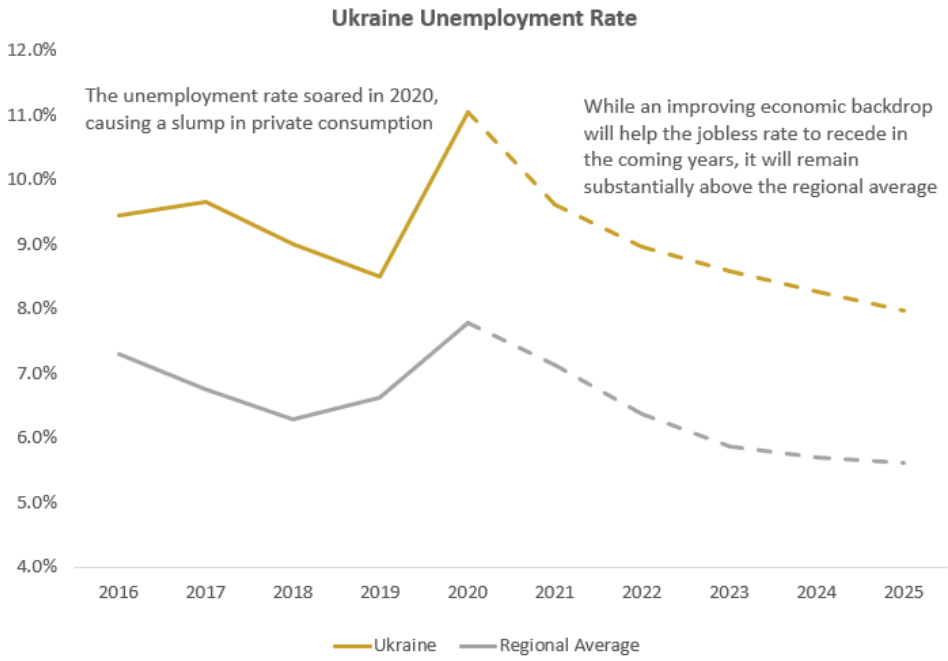
Unemployment

Unemployment surged in 2020 amid the COVID-19 crisis, with the IMF estimating that the jobless rate reached 11%, up from 8.5% in 2019. Nevertheless, the rise in the official unemployment figures has not been as sharp in Ukraine as in some of its regional peers. This is partly due to the fact that the share of informal workers in the economy remains very high (estimated at around 30%). It also reflects the strong uptake of remote working in Ukraine, especially among larger firms. While the unemployment rate should start to moderate later in 2021, it will remain elevated by regional standards.



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Inflation

Inflation decelerated rapidly in Ukraine in 2020. Indeed, annual consumer price growth slowed from 7.9% in 2019 to just 2.7% in 2020. The slump in global energy prices was a key driver of this development (oil and gas imports account for around a quarter of Ukraine's total import bill). The projected pick-up in economic activity in 2021 will lead to a rise in demand side inflation pressures, while increasing oil prices, as well as the recent weak performance of the currency, will see cost-side pressures intensify. All in all, annual inflation is forecast to accelerate to around 6.0% in 2021.

Source: IMF; Baker Ing
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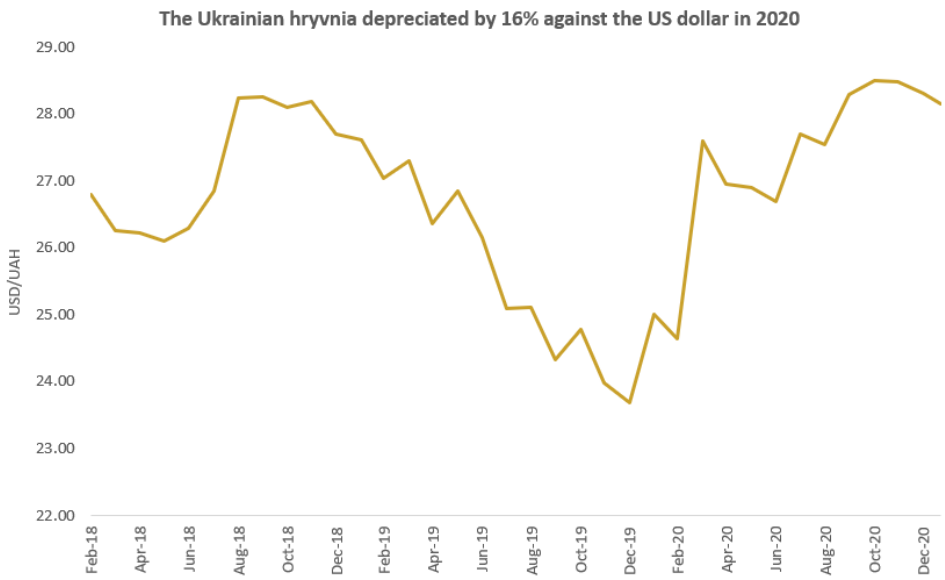
Currency Risk

The Ukrainian hryvnia depreciated by approximately 16% against the US dollar in 2020, as the global COVID-19 pandemic caused investors to flock to safe-haven currencies, such as the US dollar and Japanese yen. While global risk sentiment should firm this year, the hryvnia is unlikely to appreciate significantly. Indeed, investor caution regarding Ukraine could intensify if there is a continued lack of progress with anti-corruption reforms, as this would derail IMF financing.



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An improvement in Ukraine's terms of trade (owing to a combination of lower energy prices and higher iron prices), as well as decline in import demand (amid the COVID-19 induced slump in consumption and investment) drove the current account to swing sharply into surplus in 2020. This is unlikely to be sustained, however, as both recovering import demand and a rise in energy import costs will drive the current account back into deficit territory in 2021.

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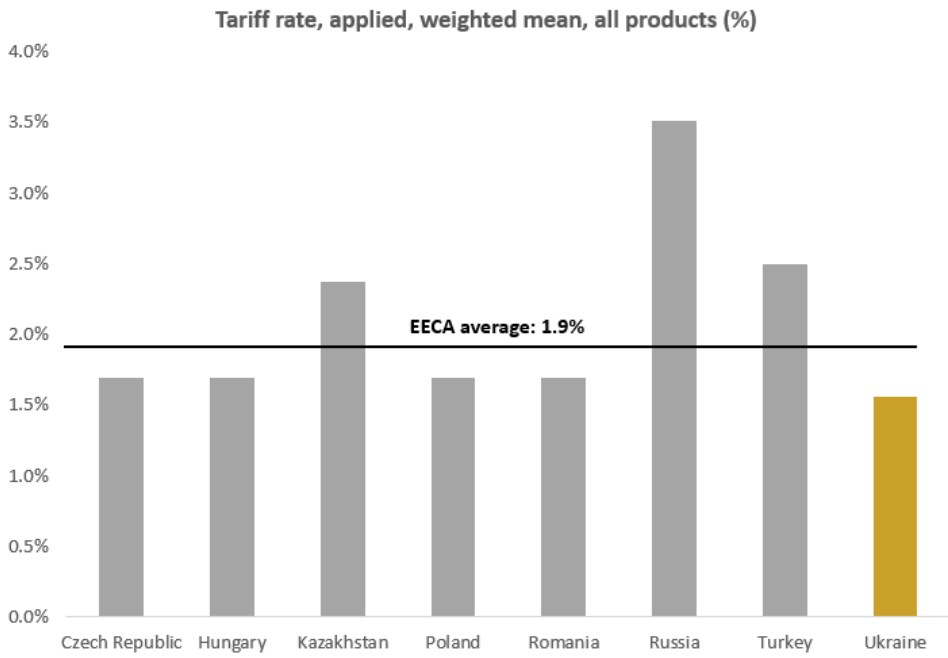
Trade Barriers

Ukraine's tariff barriers are relatively low compared with the average encountered in Eastern Europe & Central Asia. The applied weighted mean tariff rate was 1.6% in 2018 (latest data available) – 0.3 percentage points below the regional average of 1.9%. Moreover, it is also just below that of EU member countries (1.7%).



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Ukraine's non-tariff barriers to cross-border trade, however, are significant. Highlighting this, in the World Bank's *Doing Business 2020* report, Ukraine is ranked just 74th out of 190 economies globally for the category 'trading across borders.' According to the report, the time and costs associated with both exporting and importing in Ukraine are, for the most part, significantly higher than in the Europe & Central Asia region on average.

		Ukraine	Europe & Central Asia
Time to export	Border compliance (hours)	6	16.1
	Documentary compliance (hours)	66	25.1
Cost to export	Border compliance (USD)	75	150
	Documentary compliance (USD)	192	87.6
Time to import	Border compliance (hours)	32	20.4
	Documentary compliance (hours)	48	23.4
Cost to import	Border compliance (USD)	100	158.8
	Documentary compliance (USD)	162	85.9

Source: World Bank; Baker Ing

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