Morgan Stanley

November 7, 2014

CEE Economics

Perspectives on Convergence, 10 Years After EU Accession

MORGAN STANLEY RESEARCH
EEMEA

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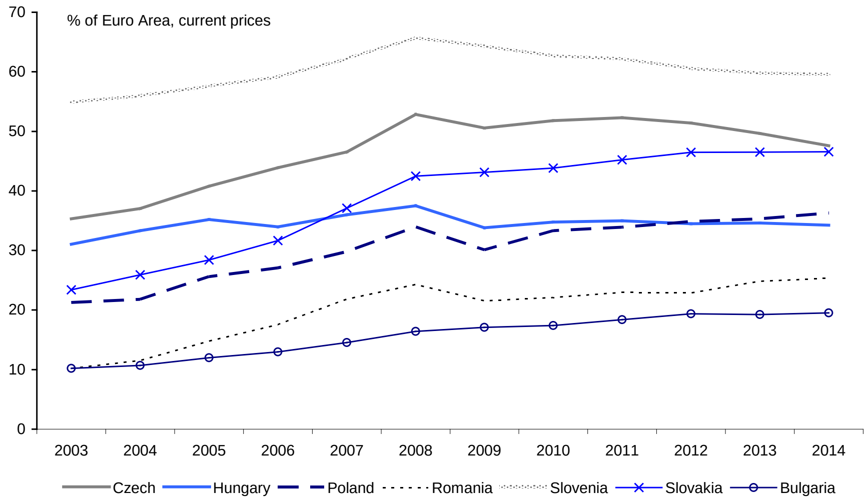
For important disclosures, refer to the Disclosures Section, located at the end of this report.

CEE: Convergence Still Under Way, Winners and Losers Begin to Emerge

Convergence still on track, at different speeds: CEE countries have GDP per capita which are around **40% of euro area (EA) levels,** up significantly since the first wave of enlargement (2004), when incomes were 25% of EA levels. However, we note that the bulk of this convergence took place between 2004 and 2008, before the Great Financial Crisis. In recent years, countries such as **Slovakia, Poland** and **Romania** have continued to converge at a **good speed,** whereas the **Czech Republic, Hungary** and **Slovenia** have disappointed.

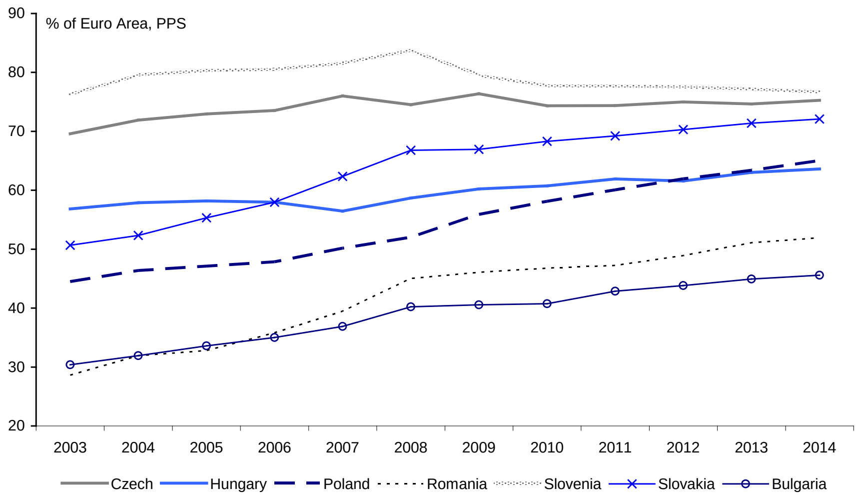
The drivers of convergence (productivity catch-up, capex) are still the same, but the *pace* of convergence is likely to slow down from the fast speed seen in the post-EU accession years. Note that in purchasing power-adjusted terms (PPS), the CEE region is already at 65% of euro area income levels, and some countries (the Czech Republic, Slovenia, Slovakia) have higher per capita GDP than Portugal or Greece, for example.

CEE: Per Capita GDP Is Around 40% of EA Levels



Source: Eurostat, Morgan Stanley Research

PPS-Adjusted, CEE Incomes Are 65% of EA Levels

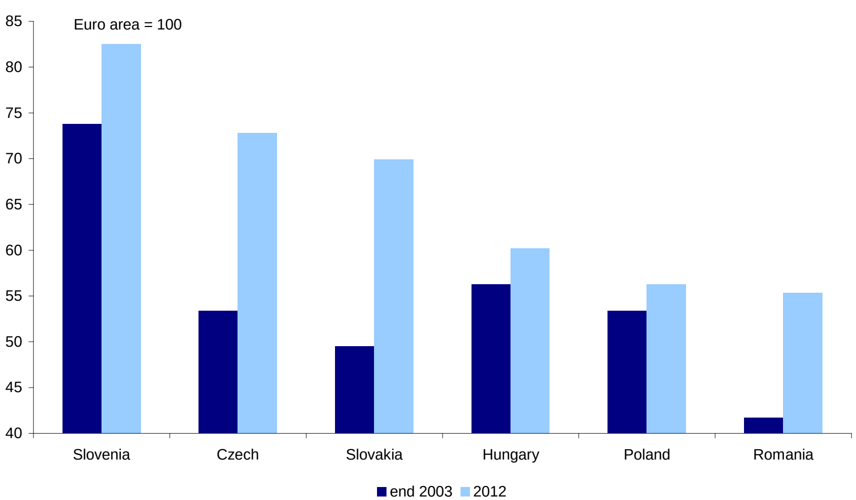


Source: Eurostat, Morgan Stanley Research

CEE: Price Convergence Is Also Under Way, as Is Consumption Pattern Convergence

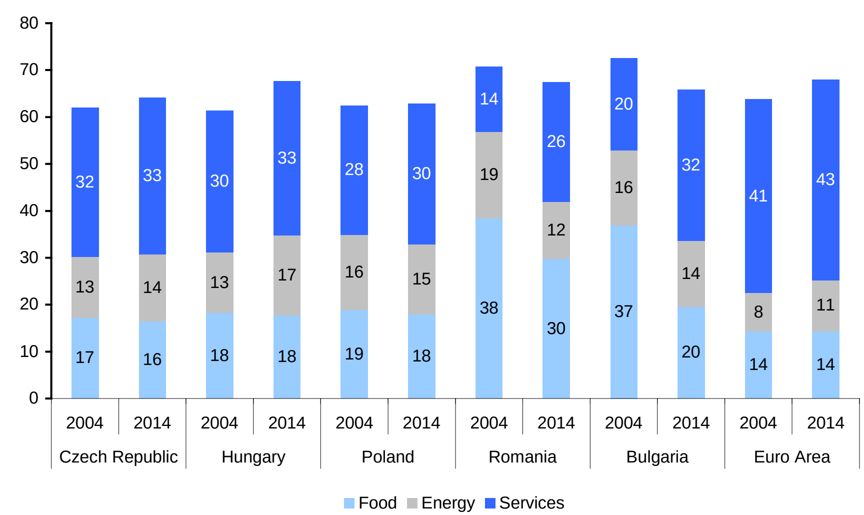
Price levels have also converged, though gap remains ample: According to the most recently available data, a combination of stronger FX (especially in the Czech Republic and Slovakia) and higher local inflation rates have resulted in **overall price convergence in CEE.** It is not surprising that as convergence takes hold, both wages and prices also tend to approach Western European levels. However, we note that **the gap is still fairly sizeable (around 40%).** In terms of their consumption patterns (as gauged by the CPI basket), CEE countries tend to spend more on necessities, such as food and energy. This is very common for developing economies. Over time, as incomes catch up to Western European levels, we would expect the proportion of income spent on leisure, travel and other services to approach euro area levels (over 40%). Note that these trends have already started to show in the data, particularly in Romania.

CEE: Price Convergence via Both FX and Inflation



Source: Eurostat, Morgan Stanley Research

Over Time, More Spending on Services, Less on Essentials



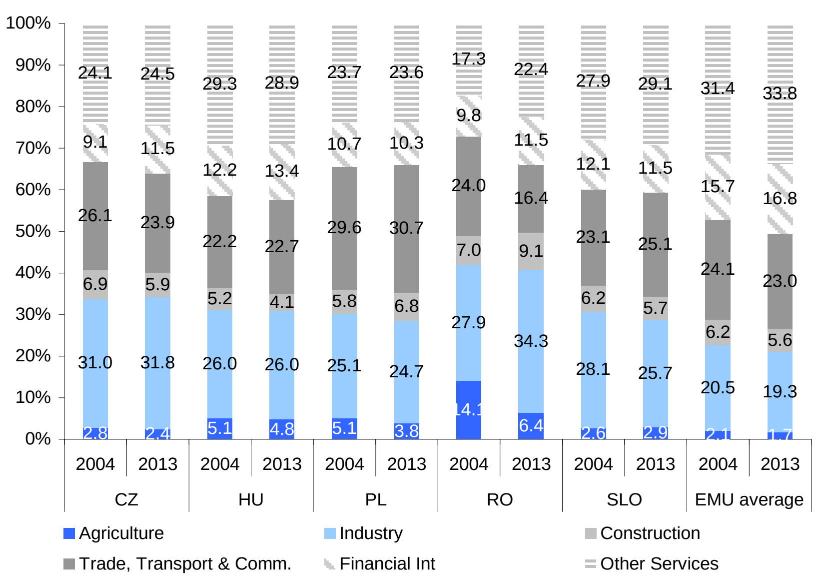
Source: Eurostat, Morgan Stanley Research

CEE: Industry Dominates the Supply Side; Looking Beyond Germany

What about the supply side? The CEE economies are **mostly reliant on industry,** due to the ample FDI they have received in manufacturing as well as their strong integration in the German industrial chain. Within industry, **CEE's comparative advantage is clearly in sectors such as automotive.** Poland, the Czech Republic, Hungary and Slovakia (i.e., the 'Visegrad 4') combined are the **second-largest car producer in the EU,** with around 3 million vehicles produced (Germany is on top with 5.7 million). However, their combined GDP is only 25% of German GDP.

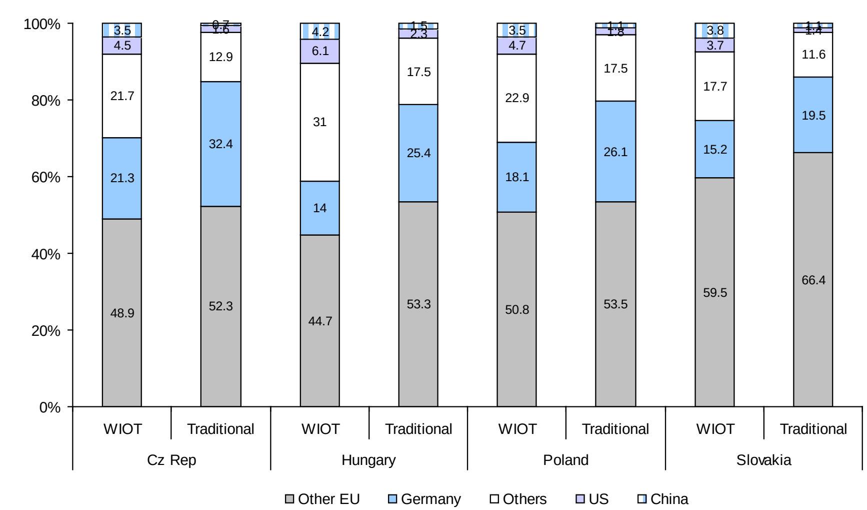
Trade with Germany is very important, but CEE is becoming more global: Often goods leave CEE in the form of machinery and equipment, arrive in Germany and then are re-exported from there onto Asia or the US. For this reason, sometimes Germany is simply acting as a **proxy for other countries' demand.** Recent IMF studies show that the dependence on German demand is 30-40% less than other data (like the IMF's DOTS) imply. This is because some exports to Germany find their way to other destinations. Germany is CEE's gateway to the world.

Industry Dominates the Supply Side



Source: Eurostat, Morgan Stanley Research

CEE Exports: Looking Beyond Germany



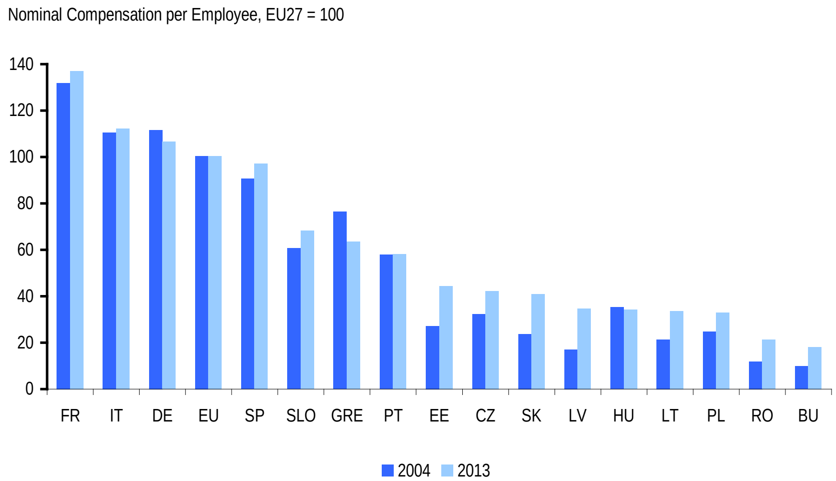
Source: IMF

CEE: Still Cheap for Foreign Investors

CEE's cost advantage is still substantial, although some of it has been eroded: Eurostat data on nominal compensation per employee show that CEE labour costs are still only around 30-40% of the European average. And even if we account for lower productivity in CEE, the cost differential is still compelling: we estimate that the level of unit labour cost in CEE is around 50-60% of the European average. The upshot is that **although the European periphery is getting cheaper, the cost advantage still very much remains with CEE.**

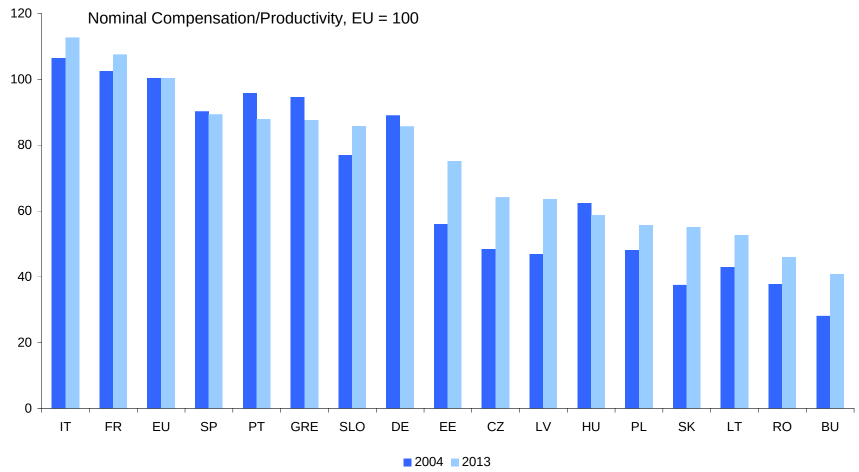
Looking beyond the cost advantage: from a more medium-term standpoint, we believe that countries in CEE will have to ensure that they invest in human capital, retain talent to avoid 'brain drain' and continue to upgrade their labour skills in order to preserve their comparative advantage. As the cost advantage erodes over time, CEE countries should aspire to move up the value chain, and invest in R&D and vocational education. Also, like the rest of Europe, CEE faces adverse demographics: it will be important for CEE countries to encourage the return of those who have migrated as well as to increase labour force participation of those currently inactive.

CEE Labour Cost Advantage Is Compelling



Source: Eurostat, Morgan Stanley Research

Cost Advantage Still Compelling When Looking at ULC

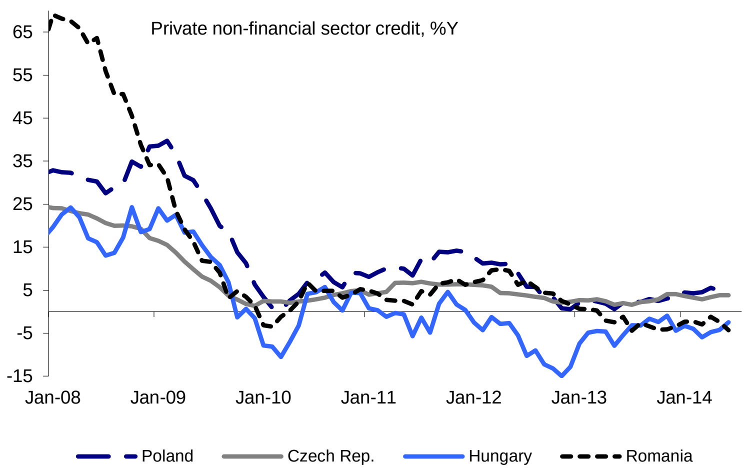


Source: Eurostat, Morgan Stanley Research; note that we updated our proxy for productivity, so this chart will look different to others we have published in the past.

CEE: Flows into the Region Are Not What They Used to Be

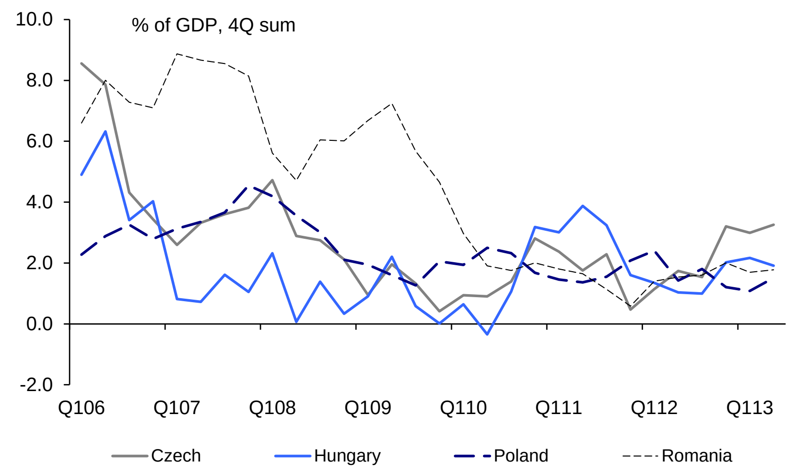
European banks dominate the CEE banking system, with 70-80% market share: Western European banks expanded aggressively in CEE in the years prior to the financial crisis, as they believed the CEE region would outgrow the euro area, and that **financial intermediation was still in its early stages,** with private sector credit/GDP at comparatively low levels. Essentially, European banks saw CEE as a high-growth region, and fought to gain market share, granting abundant credit, **very often in foreign currency** (particularly in countries where local rates were high – Romania, Hungary and to some extent Poland). Since 2008, European banks have cut down the supply of credit, and they have actually **reduced** their presence in some countries (especially **Hungary** and **Slovenia**). Credit growth is only beginning to turn up modestly, but remains in single-digit levels. A similar story holds for FDI flows into CEE, which also include intercompany loans.

Credit Bubble Burst Post-Crisis



Source: Haver Analytics, Morgan Stanley Research

FDI Flows Not as Ample as They Used to Be



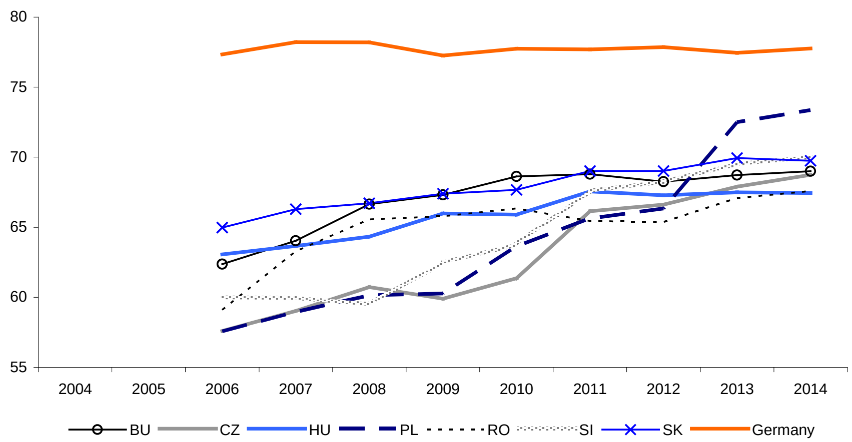
Source: Haver Analytics, Morgan Stanley Research

CEE: The Institutional Gap Has Narrowed (i)

Has the institutional gap closed since accession? It is interesting to investigate **how CEE's institutional set-up has evolved over the last 10 years.** The issue is obviously very complex. In this and the next slide, we refer to the DTF (Distance to Frontier) indicators produced by the EBRD. These are synthetic indicators made up of components such as getting credit, protecting investors, opening a business, dealing with construction permits, enforcing contracts and resolving insolvency, among others. A score of 100 represents *the frontier*, i.e., the 'optimum' that countries should be striving to achieve. In the charts, we show the main CEE countries versus Germany as a reference point.

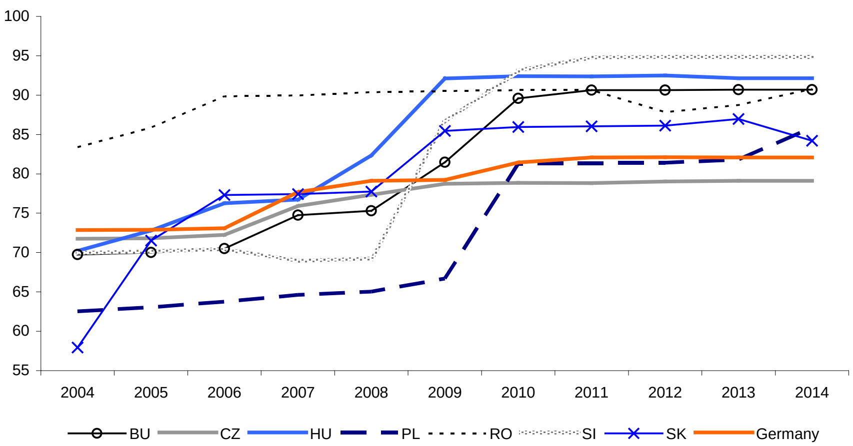
Some 'institutional convergence' has happened, but much more to come: On the overall indicator (see LHS chart), there has been clear convergence, with some countries (such as Poland) doing especially well. Looking at various components, CEE does well in 'starting a business' – where most countries even outperform Germany.

Overall Distance-to-Frontier (DTF) Indicator



Source: EBRD, Morgan Stanley Research

DTF: Starting a Business

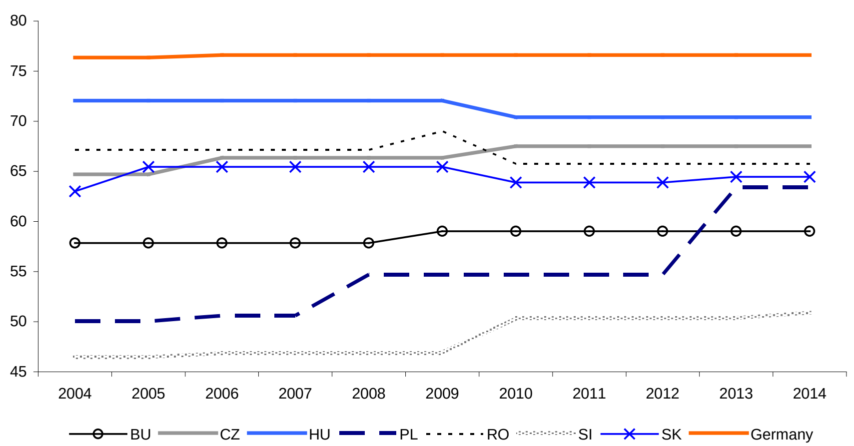


Source: EBRD, Morgan Stanley Research

CEE: The Institutional Gap Has Narrowed (ii)

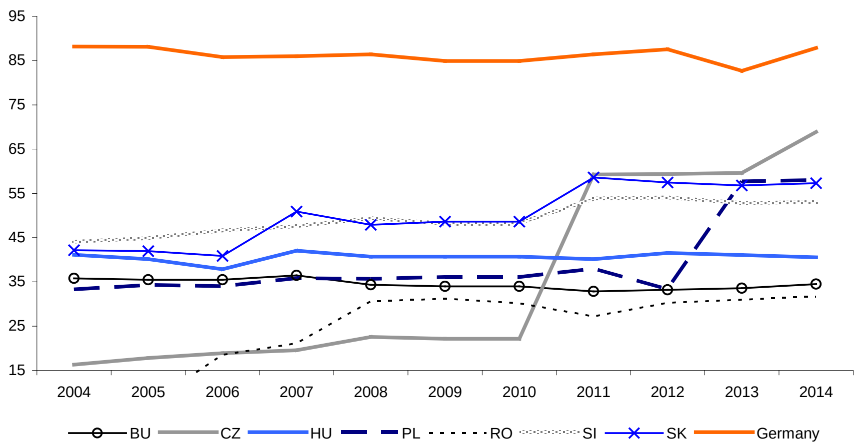
Challenges remain: CEE countries continue to lag behind in other areas, such as enforcing contracts, resolving insolvencies and paying taxes. Overall, it is difficult to say what *would have happened* in the absence of EU membership, as there is obviously no counterfactual. However, it is likely that **being part of the EU institutional framework and having to comply with EU directives provided a strong anchor for institutional progress** across the CEE region.

DTF: Enforcing Contracts



Source: EBRD, Morgan Stanley Research

DTF: Resolving Insolvency



Source: EBRD, Morgan Stanley Research

Key Takeaways

Eight CEE countries joined the EU in May 2004, Bulgaria and Romania joined in 2007, and Croatia only in 2013. Ten years after the first 'big bang' enlargement, we reflect on how the largest CEE economies in our coverage have fared. Below are our **key takeaways:**

i) **Income convergence** has progressed, with nominal GDP per capita at 40% of euro area levels, up from 25% ten years ago. However, winners and losers have emerged. Poland, Slovakia and Romania have continued to converge in terms of GDP per capita, whereas others (the Czech Republic, Hungary and Slovenia) have done worse, probably also as their starting point was higher.

ii) **Price convergence** has also taken place, courtesy of higher inflation and FX gains – however, we note that the price gap between CEE and the euro area is still around 40%, so there is plenty to catch up here too. In terms of consumption baskets, we expect CEE countries to spend proportionately more on services and less on necessities as they get richer.

iii) On the **supply side,** the CEE economies are as reliant on **industry** today as they were ten years ago, and far more than the euro area. Being part of the German supply chain is a key reason for this, and therefore one may expect manufacturing as a percentage of value added to remain relatively high even as these economies continue to converge.

iv) In terms of **trade,** the CEE region has become even more open and integrated in global trade than it was ten years ago. The region remains **cost-competitive,** both looking at wages as well as unit labour costs.

v) **The 'easy convergence' years are over: bank deleveraging, slower inflows and demographics are key medium-term challenges for CEE:** the region experienced a classic boom-bust cycle in lending and real estate, which it is still reeling from. European banks are far more discriminating now in terms of their CEE exposure, and in some countries (Hungary, Slovenia) they have scaled back their presence significantly. FDI flows into the region are also much slower.

Appendix

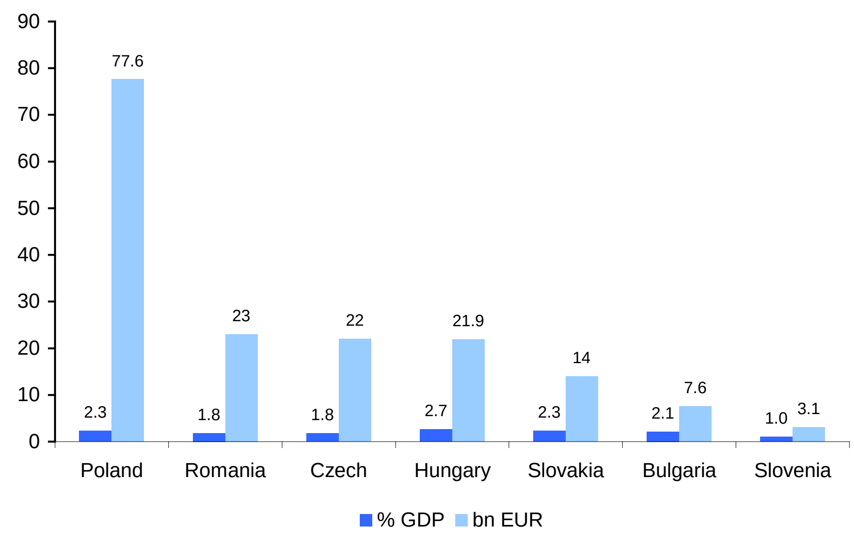
EU Funds Have Aided Convergence, and Will Likely Continue to Do So

EU funds have been helping convergence, and will likely continue to do so: We look next at the sum of the ERDF (European Regional Development Fund), the CF (Cohesion Fund) and the ESF (European Social Fund) allocations to CEE countries. Over 2007-13, CEE countries were allocated an average of EU funds worth 2.5% of annual GDP. **Absorption rates vary widely across CEE,** with Poland at 67% being particularly efficient between 2007-13 (especially versus Romania at just 37%). In the 2014-20 budget, CEE countries have received a *higher* overall nominal amount, though most likely this will be lower as a percentage of *projected* GDP over that period. The upshot is that **these funds have not yet exhausted their role as a driver of convergence.**

2007-13 EU Fund Programme…

	Available Funds		Paid Funds		Absorption rate (%)
	bn EUR	% of GDP	bn EUR	% of GDP	
Hungary	24.9	3.6	14.6	2.1	58.6
Poland	67.2	2.7	44.8	1.8	66.7
Bulgaria	6.7	2.6	3.2	1.3	47.8
Czech	26.5	2.6	13	1.3	49.1
Slovakia	11.5	2.5	5.5	1.2	47.8
Romania	19.2	2.1	7.1	0.8	37.0
Slovenia	4.1	1.6	2.5	1.0	61.0

…and a 2014-20 Overview



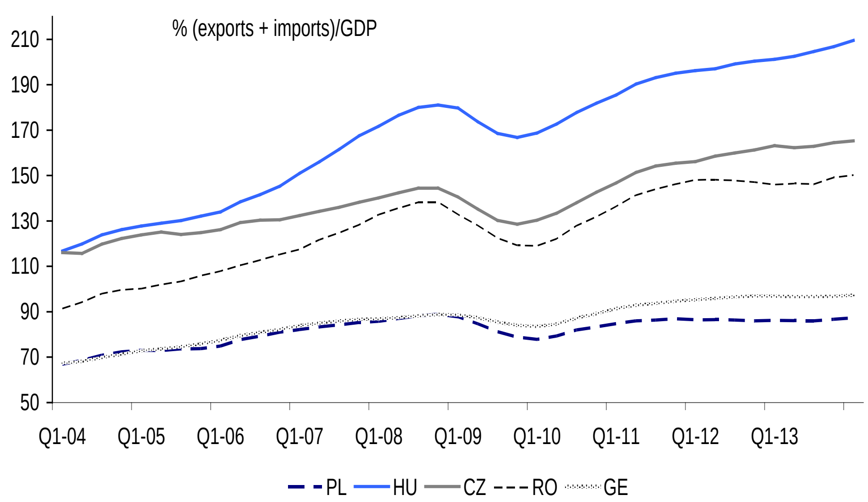
Source: European Commission

CEE: Open for Business

Open for business: CEE economies are **small and open,** with the exception of Poland (the largest of them all). The combined sum of imports and exports stands at over 200% of GDP in Hungary, 165% in the Czech Republic and 150% in Romania, compared to 87% in Poland. What's more, in recent years these ratios have risen across the board as a share of GDP as domestic components have been subdued and trade has held up better. *Intermediate goods* trade is particularly important for CEE.

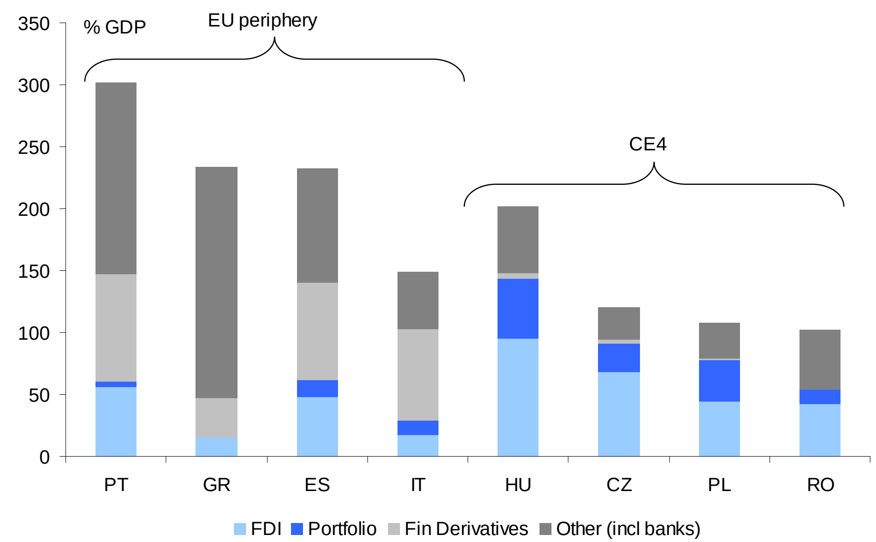
FDI is a key engine of growth: FDI from Western Europe (mostly Germany) has favoured technology transfer, innovation and efficiency gains. In CEE, FDI accounts for a much larger portion of external liabilities (40-60%) than in the periphery of the euro area, where banking flows have been much larger. With some caveats, FDI is a comparatively stable source of investment. Conversely, inflows which are mostly financial in nature (bank inflows, for instance) tend to be more flaky and give rise to boom-bust cycles.

CEE Economies Are Very Open



Source: Haver Analytics, Morgan Stanley Research

FDI Is a Large Share of External Liabilities



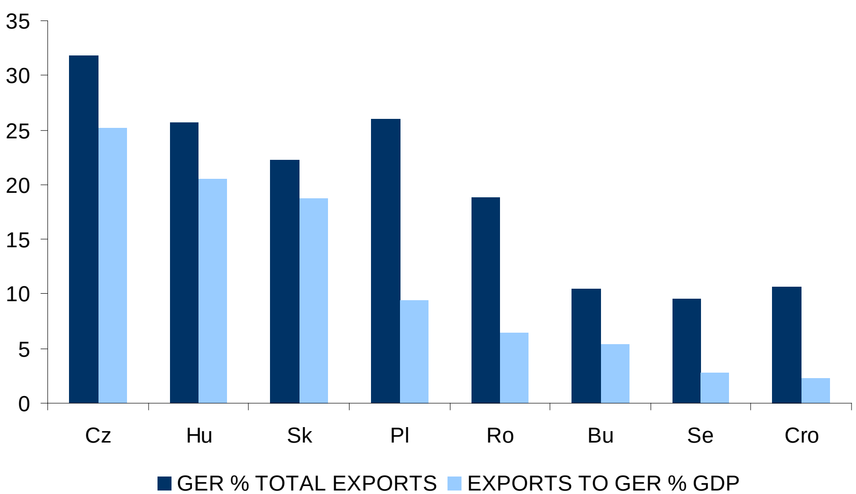
Source: Haver Analytics, Morgan Stanley Research

CEE: Looking Increasingly Beyond Germany

Trade with Germany is very important: In the Czech Republic and Hungary, exports to Germany account for 25% and 20% of GDP, respectively, whereas the ratios in Poland (10%) and Romania (6%) are smaller. Similar relationships exist on the import side.

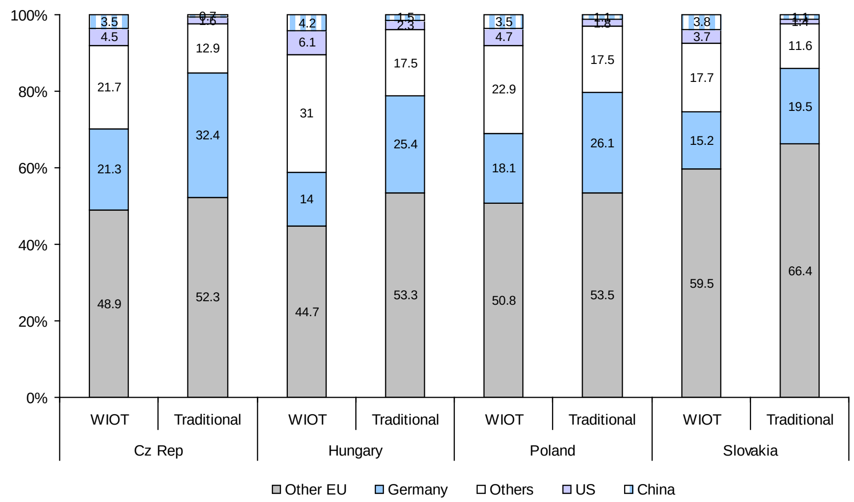
But the official trade data mask an interesting underlying change: CEE is becoming more global: Often goods leave CEE in the form of machinery and equipment, arrive in Germany and then are re-exported from there onto Asia or the US. For this reason, sometimes Germany is simply acting as a **proxy for other countries' demand.** A new data set (the World Input Output Database) allows for a more granular description of trade flows. Recent IMF studies show that the dependence on German demand is 30-40% less than other data (like the IMF's DOTS) imply. This is because some exports to Germany find their way to other destinations. The upshot is that, in such an integrated supply chain, **Germany is CEE's gateway to the world,** and CEE is increasingly trading with other regions (likely Asia and other EM).

Trade with Germany Dominates, Especially in Cz, Hu



Source: Haver Analytics, Morgan Stanley Research

Looking Beyond Germany – a New Database

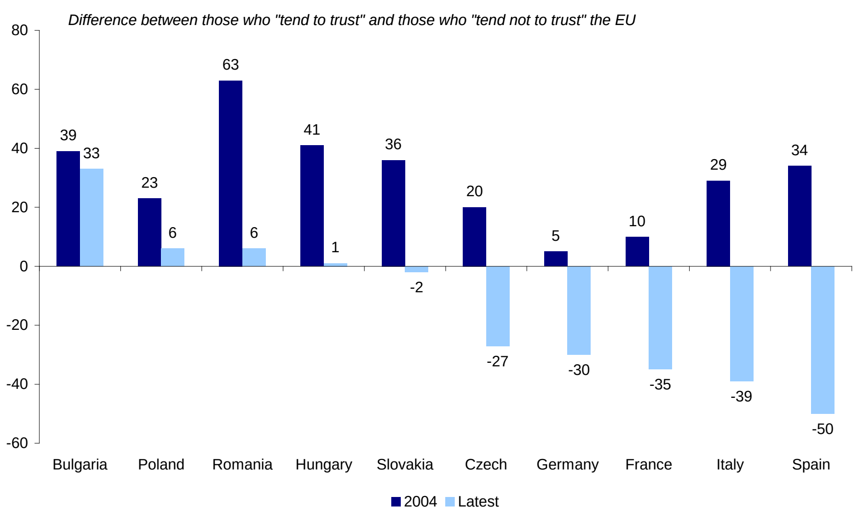


Source: IMF, Morgan Stanley Research

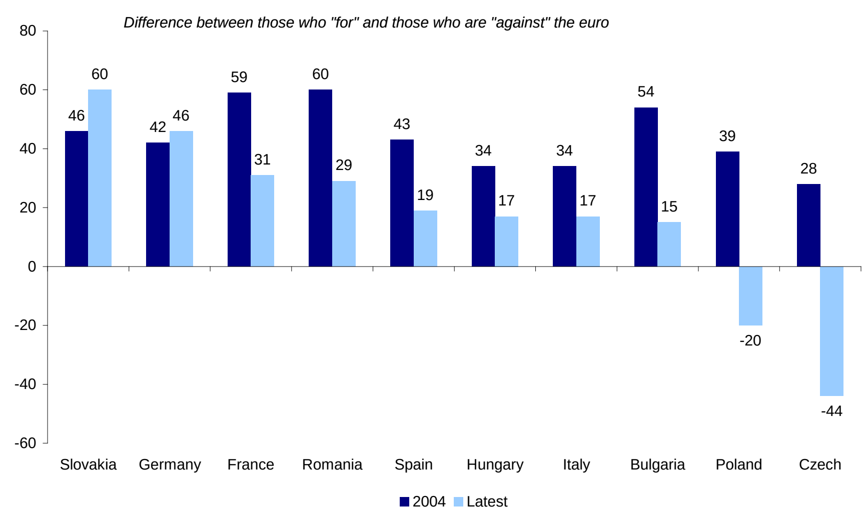
How Has Public Opinion in CEE Changed Since 2004?

Anti-EU sentiment has risen in CEE, but to nowhere near as much as in the euro area: Perhaps because CEE countries saw the concrete benefits from the EU structural funds, they still tend to either like the EU or be indifferent (with the Czech exception), in contrast with euro area citizens. Of course, this is a far cry from the enthusiastic pro-EU stance CEE voters had in 2004. When asked about the euro, Czechs and Poles have turned outright eurosceptic. It looks as if in every country euro adoption is off the table, and even in those countries which have a target date (Romania: 2019) this is meant to be a soft rather than a hard deadline; elsewhere (Poland) the authorities sometimes suggest that they intend to enter the euro area on their own terms, i.e., by avoiding ERM2. The bottom line is that **none of the CEE countries will enter the euro area any time soon, in our view.**

EU-Enthusiasm Has Waned, Though Higher than in West



Euro Picture Is Mixed, Czechs Most Eurosceptic



Source: Eurobarometer for both charts

The Long-Term View: CEE Is Still Under-Banked

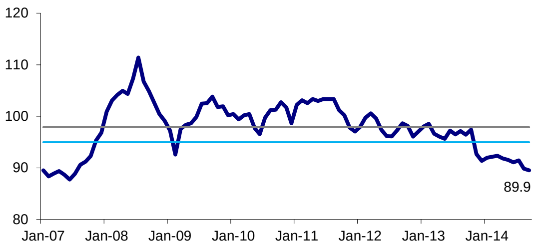
More selective exposure, perhaps; but the region *is* still fundamentally under-banked: When we look at the evolution of credit in CEE, we see that private sector credit/GDP has *fallen* over recent years and that even in the country where it is highest (the Czech Republic) it stands at **just over 50%, roughly half of the European Union level.** If one believes in convergence, it is likely that as these economies get richer, financial intermediation will also increase, as measured by credit/GDP. This medium-term perspective is one of the key reasons why Western banks by and large remain committed to CEE, though they differentiate their exposure on a country-by-country basis far more than they used to in the past.

% GDP	Czech Republic						Hungary						Poland						Romania					
	Households		NFC		Total PS credit		Households		NFC		Total PS credit		Households		NFC		Total PS credit		Households		NFC		Total PS credit	
	local ccy	FX	local ccy	FX	local ccy	FX	local ccy	FX	local ccy	FX	local ccy	FX	local ccy	FX	local ccy	FX	local ccy	FX	local ccy	FX	local ccy	FX	local ccy	FX
end-2004	10.6	0.0	12.8	2.9	23.4	3.0	12.7	1.8	13.7	10.5	26.4	12.3	9.1	3.0	9.8	3.2	18.9	6.2						
end-2005	13.2	0.0	13.9	3.0	27.1	3.0	12.2	5.0	13.9	12.1	26.1	17.1	10.3	4.1	9.6	2.9	19.9	7.0	4.1	3.3	5.0	7.1	9.1	10.3
end-2006	15.8	0.0	15.4	3.5	31.2	3.6	11.5	8.6	14.9	12.6	26.4	21.1	12.3	5.5	10.3	2.9	22.5	8.4	6.7	4.7	6.9	7.5	13.6	12.2
end-2007	19.3	0.0	16.8	3.5	36.1	3.5	10.6	13.0	14.1	15.0	24.7	28.1	15.9	6.2	11.9	2.8	27.8	9.0	8.1	9.1	7.8	9.7	15.9	18.8
end-2008	22.1	0.0	18.0	4.1	40.1	4.1	9.7	19.4	12.6	17.6	22.3	37.0	17.8	11.7	13.3	4.3	31.1	16.0	8.0	11.3	7.9	10.4	15.9	21.7
end-2009	25.0	0.0	16.9	3.9	41.9	3.9	10.3	20.3	12.6	17.3	22.9	37.6	19.8	11.5	12.1	4.0	32.0	15.5	7.7	12.3	7.8	11.4	15.6	23.6
end-2010	27.1	0.0	16.8	3.8	43.9	3.8	10.6	21.7	12.1	16.5	22.7	38.2	21.1	12.8	11.5	3.6	32.6	16.4	6.9	12.6	7.6	12.3	14.5	25.0
end-2011	28.6	0.0	17.5	4.2	46.1	4.2	10.9	19.9	11.3	16.6	22.2	36.5	21.4	13.8	12.3	4.3	33.7	18.1	6.3	12.4	8.0	12.7	14.3	25.1
end-2012	29.4	0.0	17.8	3.9	47.2	4.0	11.4	14.4	11.1	13.6	22.4	28.0	21.9	11.8	12.4	3.7	34.3	15.5	5.9	11.9	8.3	11.9	14.2	23.9
end-2013	30.4	0.0	17.4	5.0	47.7	5.0	10.8	12.7	11.6	11.4	22.4	24.1	23.5	10.8	12.0	3.8	35.5	14.7	5.5	10.9	7.8	10.1	13.3	21.0
Latest	30.2	0.0	17.3	4.6	47.5	4.7	10.6	12.7	11.2	11.4	21.8	24.0	23.8	10.7	12.2	4.0	36.0	14.7	5.5	10.4	7.9	9.5	13.3	19.9

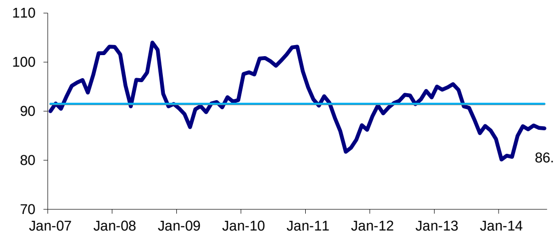
Source: Haver Analytics, Morgan Stanley Research

CEEMEA Real Exchange Rate Monitor

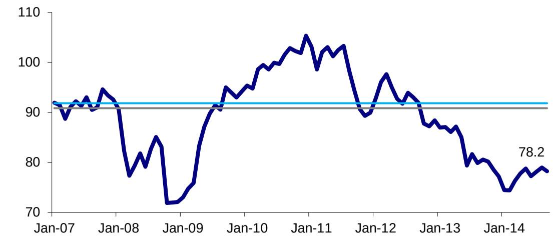
Czech Republic



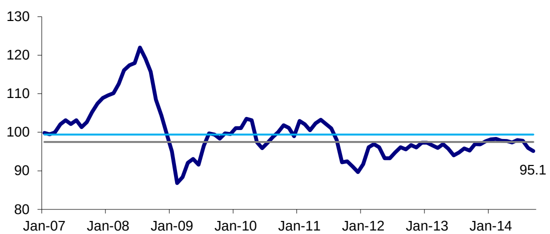
Turkey



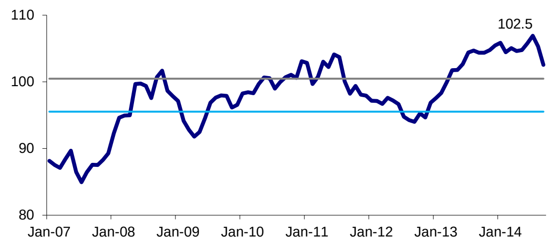
South Africa



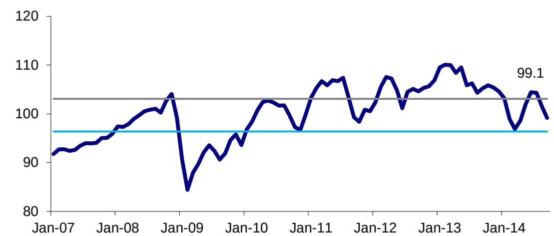
Poland



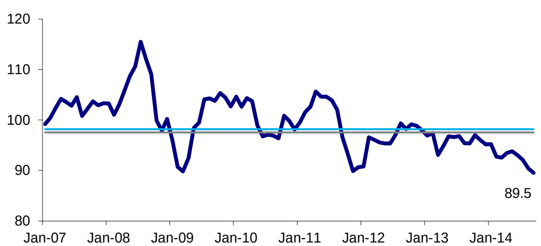
Israel



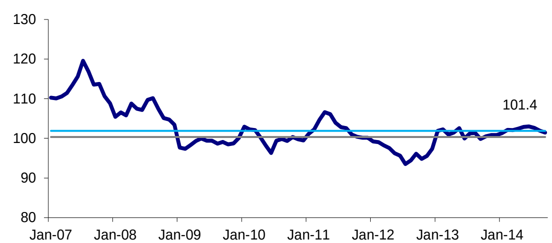
Russia



Hungary

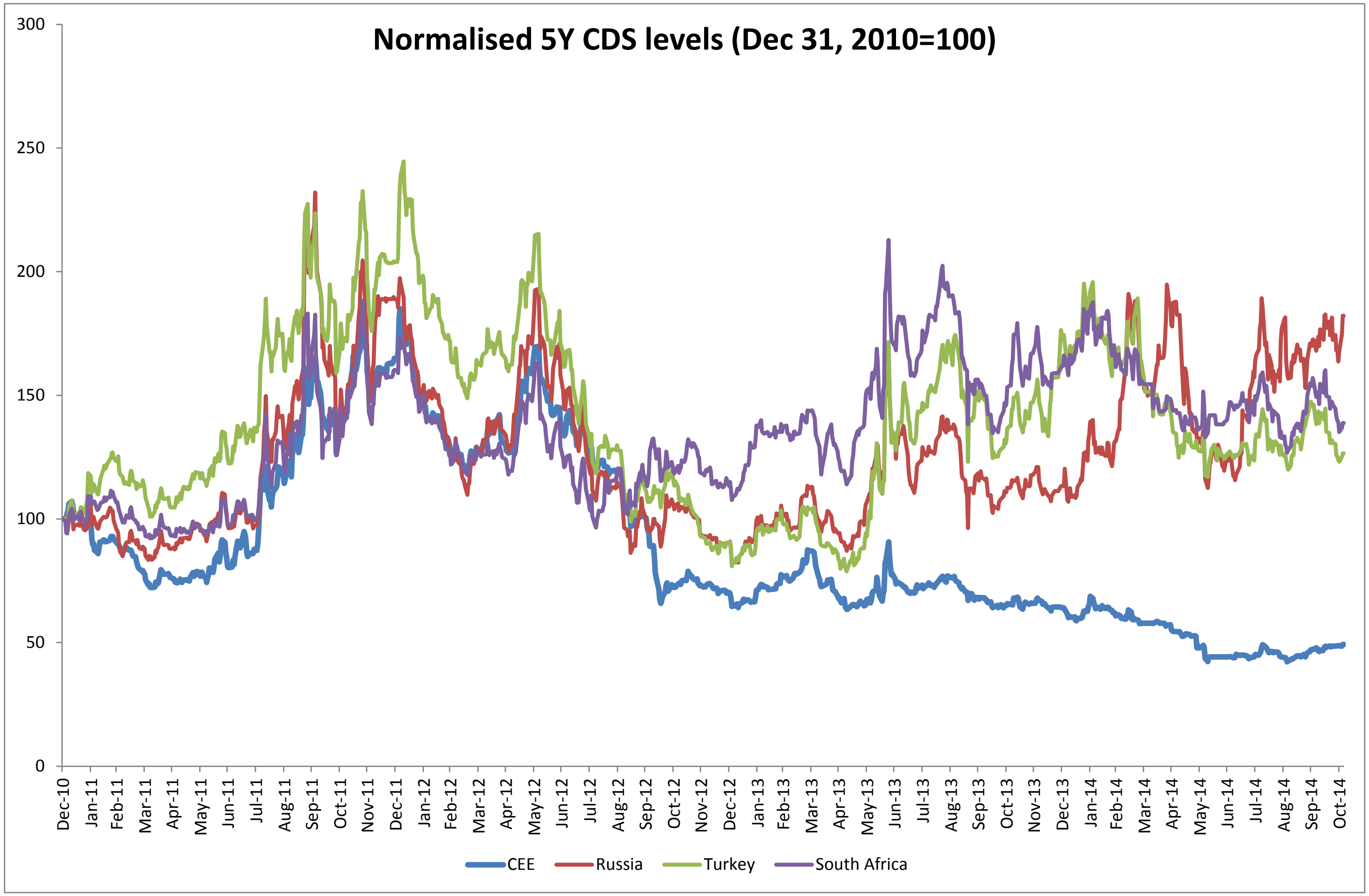


Romania



Source for all charts: Haver Analytics, Morgan Stanley Research estimates. Note: The grey line shows the 5-year average, the blue line shows the 10-year average.

CEE Decouples from the Rest of the Region



Source: Bloomberg

Global Monetary Policy Rate Forecasts

	Current	4Q14	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16	3Q16	4Q16
US	0.125	0.125	0.125	0.125	0.125	0.125	0.625	1.125	1.625	2.125
Euro Area	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05
Japan	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
UK	0.50	0.50	0.75	0.75	1.00	1.25	1.25	1.50	1.75	2.00
Canada	1.00	1.00	1.00	1.00	1.25	1.50	2.10	2.50	3.00	3.60
Switzerland	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Sweden	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.25	0.50
Australia	2.50	2.50	2.50	2.50	2.50	2.75	3.00	3.25	3.50	3.50
New Zealand	3.50	3.50	3.50	3.75	4.00	4.25	4.25	4.25	4.25	4.25
Russia	9.50	9.50	9.50	9.50	9.00	8.50	8.25	8.00	7.75	7.50
Poland	2.00	1.75	1.75	1.75	1.75	2.00	2.25	2.50	2.75	3.00
Czech Rep.	0.05	0.05	0.05	0.05	0.05	0.05	0.25	0.50	0.75	1.00
Hungary	2.10	2.10	2.10	2.10	2.10	2.10	2.25	2.25	2.50	3.00
Romania	3.00	2.75	2.75	2.75	2.75	2.75	3.00	3.25	3.50	3.75
Turkey	8.25	8.25	8.25	8.50	9.00	9.00	8.50	8.50	8.50	8.50
Israel	0.25	0.25	0.25	0.75	1.25	1.75	2.00	2.00	2.00	2.00
S. Africa	5.75	5.75	6.00	6.00	6.25	6.50	6.50	7.00	7.50	7.50
Nigeria	12.00	12.00	12.00	11.50	11.00	11.00	11.00	11.00	11.00	11.00
Ghana	19.00	19.00	19.00	19.00	19.00	18.00	18.00	17.50	17.50	17.50
Kenya	8.50	8.50	8.50	8.50	8.50	8.50	8.00	8.00	8.00	8.00
China	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00
India	8.00	8.00	8.00	7.75	7.75	7.75	7.75	7.75	7.75	7.75
Hong Kong	0.50	0.50	0.50	0.50	0.50	0.50	1.00	1.50	2.00	2.50
S. Korea	2.00	2.00	2.00	2.00	2.25	2.50	2.75	2.75	2.75	2.75
Taiwan	1.875	2.000	2.130	2.250	2.380	2.380	2.380	2.380	2.380	2.380
Indonesia	7.50	7.50	7.50	7.50	7.50	7.50	7.50	7.50	7.50	7.50
Malaysia	3.25	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50
Thailand	2.00	2.00	2.00	2.00	2.00	2.50	2.75	2.75	2.75	2.75
Philippines	2.50	2.75	2.75	2.75	2.75	2.75	2.75	2.75	2.75	2.75
Brazil	11.25	11.50	na	na	na	10.50	na	na	na	na
Mexico	3.00	3.00	3.00	3.00	3.00	3.50	4.00	4.25	4.50	4.50
Chile	3.25	2.75	2.75	2.75	2.75	2.75	2.75	3.25	3.50	4.00
Peru	3.50	3.50	3.50	3.50	3.75	4.00	4.75	5.25	5.50	5.50
Colombia	4.50	4.75	4.75	4.75	4.75	4.75	5.25	5.50	5.50	5.50

Source: National Central Banks, Morgan Stanley Research forecasts

CEEMEA Structural Indicators

	Cz. Rep.	Hungary	Israel	Kazakhstan	Poland	Romania	Russia	South Africa	Turkey	Ukraine
External Debt and Reserves										
International Reserves (USD bn)	54.8	45.2	86.2	28.0	101.7	43.1	465.2	49.1	150.3	16.2
External Debt % Exports	65.5	157.5	98.1	171.3	151.8	154.0	113.9	132.2	182.9	168.6
External Debt % GDP	52.8	146.8	31.4	72.8	70.0	64.1	32.8	42.0	50.4	85.6
ST External Debt % GDP	17.3	17.4	12.3	5.0	8.0	7.0	4.2	8.4	16.4	18.2
Med. and LT External Debt % GDP	29.7	72.8	18.1	33.0	45.4	42.4	23.9	24.9	34.0	60.3
Intercompany Loans % GDP	5.8	56.6	na	34.8	16.6	14.6	7.3	8.8	na	7.1
Short-Term Debt/Reserves (%)	61.9	51.7	43.1	37.9	42.8	29.7	18.6	57.5	86.9	179.6
Total Reserves/Import (%)	37.6	39.3	92.9	47.8	41.4	56.9	100.7	42.1	57.6	17.4
Fiscal										
Budget Balance % of GDP (2013)	-1.5	-2.4	-2.9	3.5	-4.3	-2.3	-1.3	-4.0	-1.5	-6.7
Revenue, % GDP (2013)	40.9	47.7	28.3	24.5	37.5	32.7	36.1	29.2	24.5	43.6
Expenditure % GDP (2013)	42.3	50.0	31.2	21.0	41.9	35.0	37.3	33.2	26.0	50.3
Government Debt % GDP (2013)	46.0	79.2	67.6	13.5	57.0	38.4	10.6	39.7	35.0	40.7
Credit and Banking Sector										
Private Sector Credit % GDP	49.2	45.2	75.5	35.0	51.7	32.5	53.0	78.8	66.0	67.2
HH Credit % GDP	28.8	22.9	39.4	11.5	35.1	15.6	15.5	38.7	20.9	14.5
FX % Total HH Credit	0.1	53.8	na	13.3	29.8	62.1	2.1	na	0.1	42.8
NFC Credit % GDP	20.4	22.3	36.2	23.5	16.6	16.9	37.5	na	45.1	52.8
FX % Total NFC Credit	21.2	50.9	na	40.4	26.2	52.5	24.1	na	43.0	44.1
Private Sector Credit % yoy	3.0	-2.6	11.0	12.9	5.5	5.1	17.2	8.8	20.0	20.5
Loan/Deposit Ratio	0.75	0.93	1.1	1.34	1.10	1.11	1.26	1.06	1.13	1.51
Balance of Payments										
Current Account % GDP	-0.3	4.4	2.8	2.1	-1.2	-0.4	2.3	-5.5	-6.5	-8.0
Capital Account % GDP	2.3	3.5	0.6	0.0	2.5	1.0	0.0	0.0	0.0	0.2
Financial Account % GDP	4.0	-4.0	-1.9	1.9	0.2	0.5	-5.0	4.2	5.4	2.7
Direct Investment % GDP	2.0	-0.5	1.2	3.9	-0.7	-0.8	-0.4	0.8	1.3	0.9
Portfolio Investment % GDP	-1.0	0.9	-2.7	-4.4	-0.2	-0.8	-1.5	1.9	2.0	2.2
Other Investment % GDP	2.9	-4.4	-0.3	2.5	1.1	2.1	-3.1	1.4	2.1	-0.4
Reserve Assets % GDP	-6.0	-2.3	-2.0	0.6	1.7	-0.4	2.9	-0.1	-0.6	3.9
Net Errors and Omissions % GDP	0.0	-1.6	0.5	-4.6	-2.8	-0.2	-0.3	1.5	1.7	1.2
GDP and Population										
Nominal GDP (USD bn, 4q sum)	212	134	303	214	541	196	2069	337	798	167
Nominal GDP (bn, local currency, 4q sum)	4186	29956	1067	34826	1672	646	69820	3502	1655	1484
Population (mil people)	10.51	9.91	8.06	17.17	38.50	21.35	143.70	52.98	74.89	45.37
GDP per capita (USD)	20129	13553	37659	12454	14063	9196	14400	6368	10652	3680

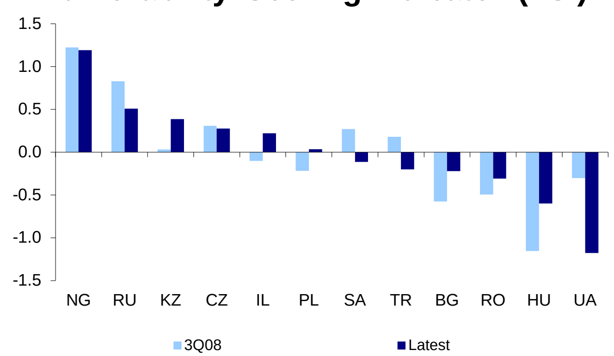
Source: Haver Analytics, Morgan Stanley Research estimates

CEEMEA Vulnerability Watch

	Turkey	Israel	Russia	Ukraine	Kazakhstan	Cz. Rep.	Hungary	Poland	Romania	Bulgaria	S. Africa	Nigeria
Latest												
C/A % of GDP	-6.1	2.8	1.8	-6.1	2.0	-0.4	4.4	-1.1	-1.7	2.5	-5.5	7.5
External debt/GDP	50.4	31.4	35.3	81.9	70.7	55.5	117.2	71.6	64.3	95.7	42.0	2.6
St external debt/FX reserves	86.9	49.4	17.8	182.6	38.2	58.8	46.8	42.7	29.7	57.7	59.5	4.6
Loan to Deposit ratio for the whole banking system	1.0	0.9	1.2	1.4	1.5	0.7	1.0	1.1	1.2	1.1	1.0	0.6
FX loans as a % share of total PS credits (HH + NFC)	27.0	10.3	16.8	39.6	29.1	8.1	55.8	31.3	62.7	63.9	11.7	3.5
Budget deficit % GDP	-1.2	-2.3	-0.3	-3.9	11.3	-1.2	-3.1	5.2	-1.6	-1.6	-4.3	-2.3
Gov't debt % GDP	35.8	66.3	9.3	55.4	14.0	45.0	83.2	47.5	38.5	20.2	41.9	19.8
3Q08												
C/A % of GDP	-6.0	0.7	7.1	-6.7	3.2	-2.4	-6.8	-6.4	-13.6	-23.7	-7.7	20.4
External debt/GDP	37.8	41.9	32.3	55.4	82.2	42.6	112.8	51.5	51.7	105.9	26.2	1.8
St external debt/FX reserves	48.0	111.1	19.5	73.0	47.0	77.7	116.5	84.7	64.5	87.6	80.0	2.1
Loan to Deposit ratio for the whole banking system	0.8	0.9	1.4	1.6	1.6	0.8	1.3	1.0	1.4	1.1	1.1	0.9
FX loans as a % share of total PS credits (HH + NFC)	25.2	10.0	22.6	47.0	43.9	8.5	55.9	27.6	56.1	55.5	8.0	6.0
Budget deficit % GDP	-1.6	-0.1	8.0	-0.2	4.6	-1.4	-3.5	-2.4	-5.1	2.2	1.0	-0.2
Gov't debt % GDP	37.7	70.6	5.3	9.0	8.9	27.0	66.0	42.8	11.4	14.3	24.0	11.9

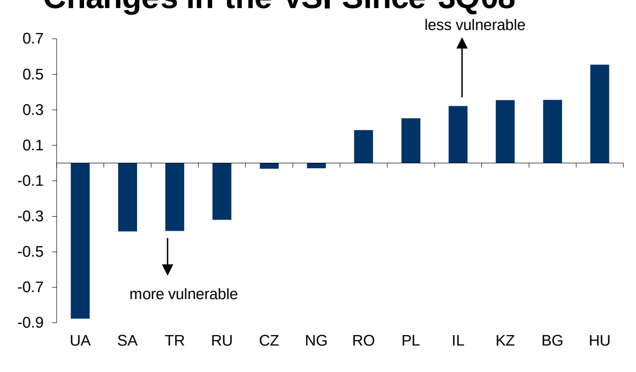
Source: Morgan Stanley Research; the chart shows an aggregation of the vulnerability metrics we show above as an equally weighted average of each indicator's deviation from the regional average (expressed in standard deviations). Source: Haver Analytics, Eurostat, national statistical offices, national central banks. Data on loans, deposits, external debt and reserves, most recent available data used. Data on external debt/GDP and government debt/GDP, latest available, based on 4Q rolling sum of GDP. Current account % of GDP and budget deficit numbers were calculated using the 4Q or 12M rolling sums, using the most recent available data.

Vulnerability Scoring Indicator (VSI)



Source: Morgan Stanley Research; the chart shows an aggregation of the vulnerability metrics we show above as an equally weighted average of each indicator's deviation from the regional average (expressed in standard deviations).

Changes in the VSI Since 3Q08



Source: Morgan Stanley Research

CEEMEA Macroeconomic Forecasts

		Cz. Rep.	Hungary	Israel	Kazakhstan	Nigeria	Poland	Russia	South Africa	Turkey	Ukraine
Real GDP growth (%)	2013	-0.9	1.0	3.3	6.0	5.5	1.6	1.3	1.9	4.0	0.0
	2014E	2.6	3.5	2.2	3.2	6.0	3.0	0.6	1.3	3.4	-7.3
	2015E	2.4	3.0	2.7	2.8	7.0	3.3	-0.5	2.5	3.8	1.2
	2016E	2.7	2.3	3.0	7.5	7.0	3.8	1.1	3.0	3.8	5.0
Private Consumption (%)	2013	0.1	0.3	3.5	10.1	na	0.8	4.7	2.6	4.6	7.8
	2014E	2.0	2.2	1.9	3.0	na	2.3	1.9	1.5	2.8	-6.5
	2015E	1.8	2.6	3.0	3.0	na	2.4	-0.9	1.7	2.5	2.0
	2016E	2.0	2.1	3.3	5.0	na	2.8	2.0	2.5	2.9	3.5
Gross Fixed Investment (%)	2013	-3.7	1.4	1.2	9.9	na	-4.6	-0.1	4.7	4.3	-6.6
	2014E	5.9	14.7	2.1	2.0	na	13.5	-8.3	2.9	2.6	-35.0
	2015E	3.5	6.4	3.5	4.5	na	7.5	-6.6	2.7	4.7	8.0
	2016E	4.1	2.5	3.4	6.0	na	7.6	5.7	3.5	5.6	13.0
Exports (%)	2013	0.2	5.3	0.9	-0.2	na	5.3	4.2	4.2	0.1	-8.8
	2014E	9.9	6.0	2.4	-1.5	na	4.2	-0.6	4.3	8.2	-9.0
	2015E	4.9	4.4	3.5	0.7	na	2.6	0.0	4.7	5.2	4.0
	2016E	5.3	4.9	4.0	7.2	na	3.8	0.6	5.5	5.6	5.5
Imports (%)	2013	0.6	5.3	-0.3	5.2	na	2.4	3.7	4.7	8.5	-5.9
	2014E	10.6	7.5	3.0	-3.0	na	6.5	-4.4	2.5	3.9	-16.0
	2015E	5.0	4.5	5.0	1.8	na	3.1	-1.1	4.5	5.7	7.5
	2016E	5.3	4.9	4.5	4.0	na	3.8	4.5	5.0	5.3	4.0
CPI Inflation (% year end)	2013	1.4	0.4	1.9	4.8	7.9	0.7	6.5	5.4	7.4	0.5
	2014E	0.8	0.5	0.8	8.6	8.9	-0.1	9.0	6.6	9.1	17.0
	2015E	2.1	2.7	1.4	7.4	7.6	2.1	6.7	5.6	7.0	7.0
	2016E	2.0	2.8	2.0	6.5	9.1	2.4	5.8	5.7	5.9	5.5
C/A Balance (% GDP)	2013	-1.4	4.2	2.4	-0.1	4.1	-1.4	1.6	-5.8	-7.8	-9.0
	2014E	0.0	2.5	2.5	1.5	3.8	-1.3	3.0	-5.2	-5.3	-3.2
	2015E	0.4	2.0	2.5	1.5	3.7	-1.4	2.8	-4.8	-6.0	-4.6
	2016E	0.4	1.8	3.0	5.0	3.1	-1.8	2.2	-5.2	-6.0	-4.0
Govt.Debt (% GDP)	2013	46.0	79.2	67.6	13.5	10.6	57.0	10.6	39.7	35.0	40.7
	2014E	45.5	80.0	68.0	16.0	10.5	49.5	11.2	42.2	35.0	68.5
	2015E	45.1	79.5	67.5	16.5	10.2	49.8	11.6	44.0	34.8	74.0
	2016E	44.5	79.5	66.0	17.0	9.8	49.2	12.2	44.9	34.5	71.8
Public sector balance	2013	-1.5	-2.4	-2.9	3.5	-1.6	-4.3	-1.3	-4.0	-1.5	-6.7
(% GDP)	2014E	-1.4	-2.9	-3.0	3.3	-1.6	5.3	-0.3	-4.3	-2.0	-10.5
	2015E	-1.4	-2.9	-2.8	3.1	-1.6	-2.9	-0.8	-3.8	-2.0	-6.5
	2016E	-1.2	-2.9	-2.5	3.1	-1.6	-2.6	-1.0	-3.0	-1.5	-4.0

Source: Morgan Stanley EMEA Economics. Notes: E = Morgan Stanley EMEA estimates; FX rate vs. EUR (Czech Republic, Hungary, Poland, Romania); FX rate vs. USD (Israel, South Africa, Russia, Turkey). For Poland and Hungary, we use gross investment instead of gross fixed investment.

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