Sanctions Cloud Outlook for Russia, Greece Secures Bailout Deal

The resolution of the Greek imbroglio dominated the news during the quarter, highlighting the crisis of confidence for the Euro-zone. The resolution of the Greek crisis and its third bailout deal is beneficial for countries such as Poland, Hungary, and the Czech Republic, which depend on the euro-zone for most of their exports. Meanwhile, big oil exporter Russia benefited during the second quarter as energy prices increased moderately despite the Ukraine crisis and the ongoing economic sanctions that continue to cloud the outlook for the economy. Turkey’s economy appears to be caught in a stalemate, resulting from the political fallout of a fractured election mandate, but lower oil prices continued to boost the oil-importing country.

At a Glance

Russia: The Russian economy had some respite during the second quarter, thanks to the moderate rebound in oil prices, though the Ukraine crisis and the extension of economic sanctions continue to affect consumer and business sentiment. Economy Minister Alexei Ulyukayev said he expects the economy to contract between 3.5 to 4 percent during the second and third quarters.

Turkey: Political uncertainty in the aftermath of the parliamentary elections held on June 7 appears to have cast a cloud over Turkey’s economic prospects. Still, lower inflation and food prices are definitely beneficial for Turkey’s economy, which expanded 2.3 percent in the first quarter of 2015.

Poland: In its recent assessment of the Polish economy, the National Bank of Poland opined that rising consumption and private sector investment would be the main drivers of the country’s economic growth in the years ahead. The bank also said lower oil prices would keep the lid on consumer prices.

Hungary: Encouraged by benign inflation and gains in currency following the resolution of the Greek crisis, the Hungarian Central Bank reduced rates to 1.35 percent on July 21, capping a series of interest rate cuts spread over three years. Inflation in the country remained at an annual
0.6 percent in the month of June.

**Czech Republic:** The manufacturing purchasing managers' index clocked 55.5 in May compared to 54.7 in April, thanks to the rise in new orders, output, and employment. The rising demand for automobiles in Western Europe was the trigger for the growth in new vehicle orders. During the first quarter, the economy of Czech Republic grew at the annual rate of 4.0 percent.

**Greece:** The Greek crisis appears to be heading toward a resolution after an agreement between the country and its creditors was signed on July 13. Though the terms of the proposed bailout and a three-year $94-billion financing program are still being worked out, the concerns of a “Grexit” from the Euro-zone have disappeared from the radar screens of global investors, at least for now.

**RUSSIA: HOPES HINGE ON SUSTAINED RECOVERY IN OIL PRICES**

The Russian economy had some respite during the second quarter, thanks to the moderate rebound in oil prices, though the Ukraine crisis and the extension of economic sanctions continue to affect consumer and business sentiment. Based on a preliminary estimate, the economy shrunk by 3.2 percent in the first five months of the year, according to a Reuters news report. Compared to the year-ago period, retail sales, an indicator of consumer confidence, fell 9.2 percent, and industrial production also decreased 5.5 percent in May. While data for the month of May was not encouraging, the dip in real wages and unemployment was better than what analysts were expecting. Moreover, the consumer price index showed a 15.3 percent year-on-year rise in June, which is expected to increase to 15.5 percent in July, according to Russia’s Economy Minister. Economy Minister Alexei Ulyukayev said he expects the economy to contract between 3.5 to 4 percent during the second and third quarters.

The recovery in oil prices, which is of utmost importance to resource exporter Russia, may not be sustainable in the long term as additional global supply and subdued demand growth could limit the rise in prices. Meanwhile, the Russian central bank has been following a policy of monetary easing, cutting the key rate to 11.5 percent on June 15 in the latest round of easing. Though analysts expect the central bank to implement more rate cuts through the year, Bank Governor Elvira Nabiullina has made it clear that inflation risks would have a bearing on its future course of action. According to a Reuters report, the central bank also upgraded its 2015 GDP forecast for the Russian economy to a contraction of 3.2 percent from its earlier view of a 3.5 percent to 4 percent decline.

**TURKEY: POLITICS TAKES THE CENTER STAGE, AGAIN**

Political uncertainty in the aftermath of the parliamentary elections held on June 7 has cast a cloud over Turkey’s economic prospects, with the former ruling AK party now forced to form a coalition with a junior party. The economy is largely dependent on foreign capital inflows to fund the deficit in its current account. With the U.S. Federal Reserve set to raise rates this year, the new political deadlock has added to the economy’s woes. Taking note, the World Bank reduced its growth forecast for Turkey in 2016 and 2017 to 3.5 percent, while leaving the forecast for the current year intact at 3 percent. In its previous forecast in April, the bank said it expected 3.9 percent growth in 2016, while its estimate for 2017 was 3.7 percent. For the current year, the government has forecast growth of 4 percent.
Turkish Finance Minister Mehmet Simsek pointed out that the country’s economic growth would be affected if the stalemate lingers and new elections are held.

Meanwhile, the Turkish Central Bank, which had differences with President Erdogan on the direction of its monetary policy, decided to leave interest rates unchanged in its review held on July 23 and avoid any mention of the country’s fluid political situation. To keep the rates on hold, the central bank focused more on moderate energy prices that benefit the oil importer as well as the recent drop in food prices. Lower inflation and food prices are definitely beneficial for Turkey’s economy, which expanded 2.3 percent in the first quarter of 2015. In more positive news, the unemployment rate narrowed to single digits in the three-month period from March to May.

POLAND: CONSUMPTION, PRIVATE SECTOR INVESTMENT SEEN TO BOOST GROWTH

In its recent assessment of the Polish economy, the National Bank of Poland opined that rising consumption and private sector investment would be the main drivers of the country’s economic growth in the years ahead. The bank estimated that Polish GDP would grow by 3.6 percent this year, while it expects growth of 3.4 percent and 3.6 percent in 2016 and 2017 respectively, according to a news report published in *Warsaw Business Journal*. The bank also said lower oil prices would keep the lid on consumer prices, which would keep inflation subdued. Considering the lower than expected levels of inflation, the central bank decided to leave the interest rate unchanged at 1.5 percent. The bank expects inflation to be negative 0.8 percent in 2015, while the government’s targeted rate is 2.5 percent.

The Polish central bank added that food prices would also remain tamed, thanks to favorable weather conditions that led to increased supply. Despite the Russian embargo on food imports from Poland, food exports increased by 6.6 percent year-on-year during the first five months of 2015, a report in the *WBJ* said. While Polish food exports to the Commonwealth of Independent States declined drastically, exports to the European Union increased by 9 percent, the report said. Poland’s overall exports also rose 8.6 percent year-on-year in May. In more positive news, seasonally adjusted industrial production increased by 5.2 percent in May compared to the year-ago period, according to Eurostat.

HUNGARY: CENTRAL BANK ENDS EASING CYCLE AS INFLATION REMAINS BENIGN

Encouraged by benign inflation and gains in currency following the resolution of the Greek crisis, the Hungarian Central Bank reduced rates to 1.35 percent on July 21, capping a series of interest rate cuts spread over three years. Inflation in the country remained at an annual 0.6 percent in the month of June. The bank had started the easing cycle to reinforce the government’s efforts to kick-start the economy. Like many emerging economies though, Hungary fears that its assets would become less attractive with the imminent rise in rates by the U.S. Federal Reserve. To lessen the impact of the Fed action, Hungary plans to reduce its exposure to borrowing in foreign currency and make domestic banks purchase more government debt denominated in forints, according to a *Reuters* report.

Meanwhile, the Hungarian Parliament approved the budget for 2016 as the most indebted country in central Europe attempts to regain its investment-grade rating. With this, officials envision the deficit coming down to 2 percent of GDP next year and forecast economic growth of 2.5 percent in 2016,
according to a *Bloomberg* report. Another important proposal in the budget is to reduce bank taxes, which has been a bone of contention between the government and the financial services industry. The Hungary of today is a far cry from the recession-hit economy of 2012, clocking an annual growth rate of above 3 percent for the past six quarters. In fact, retail sales increased at a 5.2 percent annual rate in the month of May, while food sales inched up 1.1 percent annually and non-food sales rose 9.7 percent.

**CZECH REPUBLIC: AUTOMOBILE EXPORTS DRIVE GROWTH**

The export-reliant economy of Czech Republic is largely dependent on its thriving automobile industry for driving its economic growth. The manufacturing purchasing managers’ index clocked 55.5 in May compared to 54.7 in April, thanks to the rise in new orders, output, and employment. The rising demand for automobiles in Western Europe was the trigger for the growth in new vehicle orders. During the first quarter of 2015, the economy of Czech Republic grew at the annual rate of 4.0 percent. As wage growth in 2015 was below expectations. The annual rate of inflation for the month of June touched 0.8 percent, well below the target rate of 2 percent.

In a review of the Czech economy, ratings agency Fitch pointed to the country’s strong government and prudent fiscal policies. Acknowledging that exposure to the Euro-zone affected the economy’s growth prospects in recent years, the agency said the 2014 recovery would continue to gain strength in the years ahead. Fitch said the recovery in the Euro-zone is the key driver of Czech economic activity, while domestic demand and falling unemployment levels lent support.

On the monetary policy front, the Czech Central Bank said it will continue to keep the currency weak until the second half of 2016, according to a *Reuters* news report. The bank had initially decided to devalue the currency in November 2013. Bank Governor Miroslav Singer said he was concerned about the slowing economic growth in Germany, Czech Republic’s chief trading partner.

**GREECE: ‘GREXIT’ AVERTED, BUT DEAL COMES WITH CONDITIONS ATTACHED**

The Greek crisis, which has captured global investor attention, appears to be heading toward a resolution after an agreement between the country and its creditors was signed on July 13. Though the terms of the proposed bailout and a three-year program to provide about $94 billion in financing to Greece are still being worked out, the concerns of a “Grexit” or exit of Greece from the Euro-zone have disappeared from the radar screens of global investors, at least for now. Greece is a small southern European country, which contributes just about 2 percent of the currency bloc’s GDP, and has only a marginal effect on the region’s overall growth rate. Still, any issues surrounding the country’s solvency raises big concerns about the sustainability of the Euro-zone.

The inking of the deal is just a small step in a potentially protracted process before Greece actually gets any money from its creditors, which include the European Central Bank, the European Commission, and the International Monetary Fund. Encouragingly new austerity measures were adopted by the Greek Parliament by an overwhelming majority despite strong opposition from within the ranks of Tsipras’ Syriza Party. Among the steps that received the Parliament’s nod were the adoption of European Union standards regarding bank failures and a new legal code to speed up the
courts. Meanwhile, the European Central Bank raised its emergency lending to Greek banks by about $980 million, which would help the country’s struggling banking sector. Other structural reforms in the bailout deal that are mandated include changes to the Greek pension system and the raising of funds from privatization.

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